How You Can Avoid the Disaster of

Government by Emergency

Dr. Gary North

Author of **Successful Investing in an Age of Envy**

Government by Emergency

On August 15, 1971, President Nixon "closed the gold window," floated the dollar, and imposed a price and wage freeze on the U. S. economy. There had been no public discussions of any of these moves. There had only been denials that any price freeze was being discussed inside the White House.

The next day, Monday, Treasury Secretary John Connally was asked by reporters about the lies the Administration had told concerning these actions. "Of course we had to lie," he said. "If we had told everyone in advance, they would have taken steps to evade everything." Investors should never forget this answer.

What the public was not told was that the entire Council of Economic Advisors staff had argued against a price freeze. But politics ruled the day, and the President ignored his economists. Presidents usually do.

Seven months earlier, Dr. Gary North, then a graduate student, had published an article predicting that Mr. Nixon would freeze wages and prices, and that wise citizens would take personal steps to hedge themselves. (That article is reprinted in this book: "Inflation and the Return of the Craftsman.")

What the public never understood is that the President acted unilaterally when he stopped all payments of gold to foreign central banks, and he never appealed to any legislation to authorize his action. He simply shut the window. Nobody complained.

A year before, in August of 1970, Congress had passed a law authorizing the President to freeze prices. Mr. Nixon said at the time that he would never do it. Most businessmen, if they even knew about this law, believed the President. So did most consumers. They lost.

This experience convinced Gary North of the accuracy of a political rule: "A policy has not become official until it is publicly denied by an official." Businessmen, investors, and consumers who refuse to make decisions in terms of this rule are taking unnecessary risks.

President Nixon's controls were only the tip of an unseen iceberg. There are some 500 emergency orders on the books that enable any President to put the whole economy into a bureaucratic straitjacket: to freeze prices, freeze bank accounts, confiscate or control radio broadcasts, confiscate business property, and control every aspect of business.

Congress knows about some of these rules. A decade ago, a Senate subcommittee warned the Senate. Only a token restriction was placed on a few of these laws. They sit, like a ticking time bomb, waiting for a President to declare some kind of national emergency.

What kind of emergency? The laws do not say. They are open-ended. An oil embargo, failing banks, a run on the dollar in the international currency markets, the default of Latin American nations on debts owed to U. S. banks: any could serve as an excuse—a politically acceptable excuse.

Continued on back flap.

GOVERNMENT BY EMERGENCY

Other books by Gary North

Marx's Religion of Revolution, 1968
An Introduction to Christian Economics, 1973
Foundations of Christian Scholarship (editor), 1976
Unconditional Surrender, 1981
Successful Investing in an Age of Envy, 1981
The Dominion Covenant: Genesis, 1982
The Last Train Out, 1983
Backward, Christian Soldiers?, 1984
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GOVERNMENT BY EMERGENCY

Gary North

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To

Prof. Hans Sennholz

who saw first-hand what
this book predicts.

The Original 1913 Federal Income Tax Form
(Check those tax rates)

TO BE FILLED IN BY COLLECTOR. | Form 1040. | TO BE FILLED IN BY INTERNAL REVENUE BUREAU.

List No. ....

.... *District of* ....

Date received ....

INCOME TAX.

THE PENALTY
FOR FAILURE TO HAVE THIS RETURN IN THE HANDS OF THE COLLECTOR OF INTERNAL REVENUE ON OR BEFORE MARCH 1 IS $20 TO $1,000.
(SEE INSTRUCTIONS ON PAGE 4.)

File No. ....

Assessment List ....

Page .... *Line* ....

UNITED STATES INTERNAL REVENUE.

RETURN OF ANNUAL NET INCOME OF INDIVIDUALS.

(As provided by Act of Congress, approved October 3, 1913.)

RETURN OF NET INCOME RECEIVED OR ACCRUED DURING THE YEAR ENDED DECEMBER 31, 191__

(FOR THE YEAR 1913, FROM MARCH 1, TO DECEMBER 31.)

Filed by (or for) .... *of* ....
(Full name of individual.) (Street and No.)

in the City, Town, or Post Office of .... *State of* ....
(Fill in pages 2 and 3 before making entries below.)

1. Gross Income (see page 2, line 12)		$
2. General Deductions (see page 3, line 7)		$
3. Net Income		$
Deductions and exemptions allowed in computing income subject to the normal tax of 1 per cent.		
4. Dividends and net earnings received or accrued, of corporations, etc., subject to like tax. (See page 2, line 11)	$	
5. Amount of income on which the normal tax has been deducted and withheld at the source. (See page 2, line 9, column A)		
6. Specific exemption of $3,000 or $4,000, as the case may be. (See Instructions 3 and 19)		
Total deductions and exemptions. (Items 4, 5, and 6)		$
7. Taxable Income on which the normal tax of 1 per cent is to be calculated. (See Instruction 3)		$

8. When the net income shown above on line 3 exceeds $20,000, the additional tax thereon must be calculated as per schedule below:

	INCOME.	TAX.
1 per cent on amount over $20,000 and not exceeding $50,000	$	$
2 " " 50,000 " " 75,000		
3 " " 75,000 " " 100,000		
4 " " 100,000 " " 250,000		
5 " " 250,000 " " 500,000		
6 " " 500,000		
Total additional or super tax		$
Total normal tax (1 per cent of amount entered on line 7)		$
Total tax liability		$

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Senator John W. Bricker
The Senate
Washington, D.C.

Dear Senator Bricker:

In my opinion I would suggest that if the Senate & Congress would abolish that awful law of supply and demand it would increase production. Stop hoarding for high prices as is now being done by the government and others. Push all products for sale to the markets and start competition. The law of supply & demand is a burden to the Consumer because they foot all the bills.

Trust you and your fellow senators and congressmen will act promptly.

Gerald V. ______

(Taken from *Dear Mr. Congressman*, by Juliet Lowell [New York: Duell, Sloan and Pearce, 1948], p. 91.)

INTRODUCTION

"Government by emergency": What does it mean? It means that the powers of the Federal bureaucracies are about to be greatly expanded. It means government by overnight executive orders. The first executive order was signed "into law" without the approval of Congress by President Wilson in 1916, just prior to our entry into the First World War. There are now about 13,000 executive orders on the books. Nobody has catalogued them into a coherent whole. Nobody understands more than a fraction of them. Yet the whole Federal bureaucracy operates in terms of them. When a President fears a delay or a deadlock in Congress, he resorts to executive orders. Hardly anyone outside the government knows anything about them. They receive little space in standard civics textbooks. But day by day, *government by executive order* expands.

The defeat of the Republican Party's candidates for the House of Representatives in November of 1982, and the break-even position of Republicans in the Senate, sent a signal that was not immediately understood by the financial press: *deadlocked government*. The crisis of deadlocked government will escalate as we approach the 1984 election. The only alternative is the capitulation of the Reagan administration to the Democrats in the House of Representatives—a compromise that will be fatal politically to the Republican Party and the U.S. economy.

When I served as a congressional research assistant in the mid-1970s, I got a taste of the complexity of modern bureaucracy. When the executive branch and the legislative branch are deadlocked, the bureaucrats run free. No one can bring effective control over them, even in the best of times, but as the crisis of the Federal government intensifies, we know what will happen: power will shift perceptably to the Federal bureaucracies, including our nation's

central bank, the Federal Reserve System.

What the public does not understand is that the bureaucracies already are the basis of day-to-day government. The *Federal Register* prints the laws of the land, not just the *Congressional Record*. Each year, the *Federal Register* publishes over 60,000 pages of fine printed rules and regulations. In 1975, administrative bureaucracies in the United States issued 7,600 new rules and rule amendments, and proposed 3,000 additional amendments and rules—14% more than in 1974.[1] These numbers keep growing, year by year. In contrast to the continual output of regulations by the Federal bureaucracies, Congress in a two-year term may produce a "mere" 400 to 600 new laws. The political deadlock will make things worse: the bureaucrats will have a freer reign.

The President will face tremendous political pressures to "Do Something." That age-old refrain, "Don't just sit there; do something," will be heard throughout the land. Far better is this demand: "Don't just do something; sit there." The public has never learned this refrain. Politicians just don't believe in it.

What can the President do if Congress opposes him, or if they cannot agree on what to do? The President can do plenty. The worse the economy gets, or the more chaotic the Middle East gets, or the more vulnerable Western Europe gets, the more powerful the President gets. Or more accurately, the more powerful the *enforcing bureaucrats* get.

Steadily, silently, and systematically, a massive controls program has been put into place over the past three decades. The public knows nothing about it. Congress knows next to nothing and is impotent to do anything about it. Attempts were made by a few senators to put it under congressional control in 1976, but to no avail. (See Chapter 7, "Blueprint for Tyranny.") It just gets bigger. A secret State is being set up, day by day, right under our noses. All that is needed to establish this new, bureaucratic State is for the President to declare a national emergency. This need not be a military emergency, although this kind is the most effective in terms of public support. If the voters perceive that the emergency is real—and, in my opinion, the scare headlines in the press can persuade them—then Congress will support the President. Presidential

1. William Libby III and James C. Miller III, "The New 'Social Regulation,'" *The Public Interest,* No. 47 (Spring, 1977), p. 51.

executive orders will replace due process of law in the United States.

I know most readers will not believe this initially. I don't expect them to. What I do expect them to do is to finish this book and make a preliminary judgment about the accuracy of my evaluation. If they have further doubts, they can pursue their investigation. I have included a bibliography, along with a lot of footnotes. The evidence is available, though not always easily available. This book will get people started.

An earlier version of this book was titled, *How You Can Profit from the Coming Price Controls.* That shorter and more specialized book did not convey the comprehensive nature of the system of controls that the Federal government has established on paper—a system which can be imposed overnight. In this edition, I have expanded earlier chapters, added footnotes, and offered additional suggestions concerning a personal strategy of economic self-defense.

The Banking Crisis

This topic takes up a good deal of space in this book. Today, the discussion of a potential banking crisis is far more commonplace than it was when I first published the earlier version of this book, let alone the original reports by my newsletter, *Remnant Review.* The threat of default by the so-called Third World is obvious to everyone. Some Third World nations have already threatened to default on loan payments to Western banks. What has been the response of the banks? To loan them more money so that they can keep on making their interest payments. This may sound crazy, but it isn't. It happens because of government accounting rules regarding the legal solvency of banks. This is the *book-value game*, which I discuss in Chapter 9. You could easily become one among millions of losers in this "game," unless you take certain steps that I outline in this book.

Some readers may be immediately concerned about their own banks. If so, I recommend the services of Veribanc, an independent firm which makes computerized analyses of the solvency of American banks. For $25, you can submit the name and address of a local bank and receive an analysis and rating of its safety. For another $25, you can get a list of top-rated banks in your region of the country. To receive forms for making an inquiry about your bank or savings & loan association, write:

Veribanc
P. O. Box 2963
Woburn, MA 01888

Information and Motivation

As is the case of all those involved in any major undertaking, authors of "how-to" books try to accomplish several objectives with a book. They probably want to make a profit. They want to inform people. In the case of a "self-help" or "how-to" book, they want to motivate people to take a series of steps in their lives. I have all of these goals in mind.

My profit motive is self-explanatory. I do need to talk briefly about information and motivation. You can turn to Chapter 20 right now and get the basic steps I recommend for personal and family profit during a period of price and wage controls. Many of you will be familiar with at least some of these profit suggestions. The whole "hard-money" advisory industry—Harry Schultz, Harry Browne, Howard Ruff, Jerry Smith, etc.—has been recommending some of these items for as long as 20 years. These investments are no longer "the latest thing."

Why spend hundreds of pages to explain why I think you should take these steps? Many reasons. First, my philosophy of providing investment advice is very simple: explain to people exactly *why* I am recommending something. I do not want people to invest significant portions of their capital in something they really do not understand, just because I said it was a good idea. This kind of "guru syndrome" is a plague, and I want no part of it. People are responsible for their decisions in life; all they can expect from anyone else is advice. So I provide as much argumentation as space, time, and the reader's patience allows.

I paint a very grim picture in this book. The advice I offer makes little economic sense unless things are really going to get as bad as I argue. Unless you believe that my scenario is essentially correct, you will not take the necessary evasive action. The steps I recommend are simply too radical for most investors. But if the controlled economy is coming, and if it is a radical break with today's free market economy, then any financial self-defense strategy has to be radical. Only you can make the personal decisions necessary to evade the worst effects of controls. If my scenario is correct, your legal and

financial ability to make effective decisions will be reduced—radically reduced—before the decade is over. This is why I am convinced that speed is of the essence.

Recession or Controls

Price controls are only part of the story, as you will discover as you read this book. But price and wage controls are the most politically acceptable form of controls. There are more people who favor price controls than people who favor food rationing, for example, despite the fact that full-scale controls, if enforced diligently, will lead to food rationing. The public wants stable prices; because voters do not understand how free markets work, they wind up calling for a program which will produce stable official prices (listed prices) but will produce a state of affairs that is detrimental to almost every citizen. Therefore, I have concentrated my attention on price controls and how to escape their effects.

The only groups that benefit from controls are the controllers, who increase their power and their opportunities for bureaucratic advancement, and those who break the controls professionally for fun and profit. Like the "Untouchables" and the "Syndicate" in the 1920s, like those "on the take" during Prohibition and those paying them off, a symbiotic relationship between enforcers and suppliers is created when governments impose controls. The quest for graft and the quest for profit combine to produce a corrupt society. The Soviet Union is the classic example.[2]

I am only too aware of the fact that I published some of these essays in my bi-weekly newsletter, *Remnant Review,* as early as 1975. I am writing this in late 1982. I do not know when you will be reading this. We still have not suffered price and wage controls. We have suffered a wild inflationary boom (1978-80) and two recessions (1975-76 and 1980-82), but no price controls. In fact, some price controls—notably, price floors under airline travel and interstate trucking—have been reduced or removed. Some price controls on energy have been removed, though not all. Thus, this book seems premature. Haven't my arguments been refuted by past events?

I expected President Carter to impose controls. Candidate Carter's chief economic advisor, econometrician Lawrence R.

2. Konstantin Simis, *USSR: The Corrupt Society: The Secret World of Soviet Capitalism* (New York: Simon & Schuster, 1982).

Klein, had testified in 1976 that if the economy returned to "double-digit inflation," the Administration would consider price controls.[3] But Klein never served in the Administration, and in early December, 1976, Carter categorically rejected mandatory controls.[4] Carter's economic advisor, Charles Schultze, announced a month later that the Carter Administration would propose a voluntary anti-inflation program.[5] The *Washington Post* (Jan. 9, 1977), featured a lengthy article on the expected voluntary controls program. The Administration announced immediately after the President's inauguration that it would seek price ceilings before the end of the year on hospital costs.[6] Carter tried "voluntary" restraints by business and labor in April of 1978. They failed, as economists and other professional skeptics expected.[7] Carter's own advisors were divided on the question of how mandatory the voluntary controls should be.[8] *Business Week* worried about the possibility of mandatory controls.[9] The President denied any such plans.[10] His "voluntary controls" program met with skepticism among big business and organized labor.[11] His program was so confusing that his Council of Wage and Price Stability had difficulty in explaining the details.[12] *The Wall Street Journal* expected Carter to impose mandatory controls in late 1978 or in 1979.[13] Jay Siegel announced in an October 18, 1979 *New York Times* essay, "Mandatory Controls Are Next." Carter's economic advisor, Barry Bosworth, stated in mid-1979 that mandatory

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3. Testimony to the House Committee on Banking, Currency and Housing (July 28, 1976). I was serving as Congressman Ron Paul's staff economist at the time, and I heard Klein give this testimony. Cong. Paul was (and is) a member of the Banking Committee.

4. *Washington Post* (Dec. 4, 1976).

5. *Washington Post* (Jan. 12, 1977). Schultze was never a believer in mandatory controls: "In my judgment mandatory wage and price controls are neither a quick nor a sure way to reduce inflation." *Wall Street Journal* (Feb. 27, 1980).

6. *Washington Post* (Jan. 22, 1977).

7. *Washington Post* (Sept. 17, 1978), Business and Finance, p. G1.

8. "Carter's Advisors Divided on How Tough To Set Voluntary Wage-Price Guidelines," *Wall Street Journal* (Sept. 19, 1978).

9. "A Step Toward Controls?" *Business Week* (Sept. 25, 1978).

10. *U.S. News & World Report* (April 21, 1978). He favored, he said, "inflation options."

11. *Wall Street Journal* (April 13, 1978).

12. "Here Are Some Answers to Questions Concerning the Wage-Price Standards," *Wall Street Journal* (Oct. 26, 1978); "Here Are More Answers to Questions On Carter's Wage-Price Guidelines," *Wall Street Journal* (Nov. 14, 1978).

13. Editorial, Sept. 11, 1978; front-page essay by Lindley Clark: Sept. 18, 1978.

controls were an "option" in 1980.[14] Sen. Ted Kennedy joined Bosworth and House Banking Committee Chairman Henry Reuss in a call for controls, in his case, a six-month freeze.[15] In mid-January, 1980, 65% of those polled by a *New York Times*/CBS poll said they favored controls.[16] *U.S. News & World Report* (March 3, 1980) reported: "As Pressure Mounts for Wage-Price Controls—" That same day (March 3, 1980), a *Business Week* editorial called for a six-month freeze on wages and prices. Three out of five businessmen surveyed by *Nation's Business* (Oct., 1979) expected controls.[17] As it turned out, these forecasts were incorrect. Carter held firm.[18] Instead we had the wild boom of 1978-80 and the crash of 1980-82.

There is nothing in this book that says that price controls are inevitable. There is nothing that says that the government will always resort to inflationary policies in order to "cure" a recession. If our leaders are willing to take the political consequences of another Great Depression, then my predictions will not come true. We will avoid price and wage ceilings. The question is: What are the odds that the politicians will stick with "tight money" policies and allow a depression? I think the odds are low. As Alfred Kahn, Carter's "anti-inflation czar," said in 1978: "If the program flops, the only alternatives are a deep recession or mandatory wage and price controls. If inflation is permitted to accelerate, sooner or later there will be a tightening, a total breakdown of the organization and morale of our economy—and that will lead to recession. The other alternative is mandatory controls, and I hope everybody realizes that having to impose such controls would constitute failure."[19] Failure or not, he also said, "If I am forced to choose between" recession and controls, "I would have to choose the controls."[20] He spoke for most politicians throughout history.

You may not believe that we face an "either/or" choice. Maybe you believe in some middle position. Certainly, most professional economists believe in the middle ground. So do most politicians, bankers, and businessmen. Mine is the "unconventional wisdom." I

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14. Associated Press story, *Durham Morning Herald* (June 5, 1979).
15. Article by Stephen Rattner, *New York Times* (Feb. 24, 1980).
16. *Ibid.* See also the article by E. J. Dione, *ibid.* (Feb. 3, 1980).
17. See also *Wall Street Journal* (Feb. 29, 1980).
18. "White House, Fearing Further Surge in Prices, Ponders Its Next Step . . . Wage-Price Reins Ruled Out," *Wall Street Journal* (Feb. 19, 1980).
19. *U.S. News & World Report* (Nov. 27, 1978).
20. Cited in "The Outlook," *Wall Street Journal* (Nov. 13, 1978).

have gone to great pains to spell out exactly why I think the conventional wisdom is incorrect, and why I think that those who invest in terms of this conventional wisdom are going to suffer economic losses.

Each time this nation has been hit by a major recession since 1965, the Federal Reserve System, our nation's central bank, has entered the government credit markets to buy U.S. government debt. Each time, the numbers get larger—prices, interest rates, unemployment, and bankruptcies. I think the FED will do it again. Eventually, the effect of monetary inflation on prices will be so horrendous that the government will have to resort to price controls to hide the grim reality of inflation from the public.

Self-Education

Because most people probably will be skeptical about the thesis of this book, they will hesitate to take seriously the suggestions I have outlined. This is why my book is ultimately an exercise in economic education. When you finish reading it, you will have a preliminary education in basic economics that very few people possess. Without your confidence in the logic of this book, you will probably not take the steps I recommend to protect yourself, your family, and your business. Thus, I am convinced that in this instance, education is motivation.

It could be that you are reading this book after full-scale price and wage controls have already been imposed. What you want to know is what to do right now. You may be completely uninterested in anything theoretical or historical. All you want are answers to your immediate problems.

I think this book will give you answers. You are not given specific answers to every conceivable problem. What you are given is a *general strategy* to the whole problem of price controls, an approach that should enable you to protect yourself to some degree. The longer controls have been on by the time you read this, the more expensive this strategy will be. The longer they stay on after you begin to hedge yourself, the less you will be able to do with your dwindling resources. But this much seems certain: you will be better off by taking my suggestions than you would have been had you never taken any of them.

A Legal Strategy (as of 1982)

I am writing these words in late 1982. All of the suggested strategies that I have put into print are presently legal. I want to stress this point. I have no control over who reads this book or when he reads it. I certainly cannot legitimately be accused of encouraging people to do illegal things in order to beat the controls. Just the opposite! I am giving people advice in advance, so that they will be less tempted to break the law once controls are imposed. But I warn you: eventually, many of the things this book recommends will be made illegal, if controls are imposed and the government seriously attempts to enforce them.

Look at it this way: I did not create this mess. Your friendly politician and his associate, the bureaucrat, dreamed this one up. Sadly, they sold the program to your fellow voters. Price controls are going to create some horrendous losses for most people; they will also create some tremendous profits for a handful. By taking some of the steps I recommend in this book, you may be able to "break even"—not be ruined, but not get rich. Without some form of hedging, you will be a loser. Most people will be. A few of you may figure out a way to apply these general principles to a specific market or two, and get very, very rich.

I think more inflation is coming. The suggestions I offer in this book will help you if we get inflation without price controls. In that sense, this is a multi-purpose book. But if controls are imposed—and I think they will be—then the program outlined here will become doubly important, for controls make the economy doubly disastrous. If you are convinced by the preliminary chapters that show you how all this came about, and how it is likely to work itself out under controls, then you may be sufficiently motivated to act in time to protect yourself.

I do not expect every reader to take every step I mention. It would be too expensive. You should not get discouraged because some of these steps are beyond your financial ability today. Do what you can, but more important, start thinking about ways that you can increase your income, so that you can take more of these steps.

For those of you who want to pursue some of these topics in greater detail, I have offered a bibliography at the end of this book. I have also included a list of suppliers. I get no kick-backs of any kind from any of them. I just offer suggestions. You have to begin

somewhere; perhaps some of these people or firms can help you get started.

If you want a really detailed study of Mr. Nixon's controls, you may be able to locate a copy of a now out-of-print 2-volume set published by the U.S. government: *Historical Working Papers on the Economic Stabilization Program,* prepared by the Office of Economic Stabilization, a subdivision of the U.S. Treasury Department. It provides a detailed history of Nixon's price controls, 1971-73. This set was published in 1974. The average reader does not need to read 1,500 pages on this topic, but a few students may want to tackle it, and some highly motivated entrepreneurs who want to find a loophole or two that may not get plugged next time (or have not been plugged yet, if you are reading this after controls have gone on). This set probably will be used by future price controllers to plug loopholes that remained open after Nixon imposed controls in 1971. (Another good introduction to how controls really work is C. Jackson Grayson's account of his job as head of Phase II of Nixon's controls, *Confessions of a Price Controller,* published by Dow Jones-Irwin in 1974.)

Conclusion

As you begin this book, I want to offer what I regard as the finest description of price controls ever written. Nothing, I suspect, will ever match it for its unforgettable realism. It was offered by U.S. Senator Wallace Bennett of Utah at a symposium on price controls held in 1951:

> At this final session, this may be the proper session in which I should share with you what I think is the most potent capsule of wisdom on this question of direct controls, on prices, on wages, or on anything else. I stood in a little country store, in a little mining town off the railroad during last fall's campaign, and we talked about inflation during that campaign, and, apologizing in advance to the ladies, the proprietor of that little store said to me, "Well remember, Senator, you can't cure dysentery with adhesive tape."[21]

If you don't want to be wrapped tightly with Federal red adhesive tape, read the chapters that follow.

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21. Aaron Director (ed.), *Defense, Controls, and Inflation* (Chicago: University of Chicago Press, 1952), pp. 246-47.

PART I

PROBLEMS

1

THE WORLD'S BIGGEST CHAIN LETTER

In earlier editions of this book, I included a comprehensive chapter, "The Six Deadly Assumptions." One of these assumptions was this: The Social Security System is Solvent. I still think this is one of the six deadly assumptions, but in the period since I wrote that chapter, so much new material has been made available which documents the deadly nature of the assumption that I had to expand the section into a full chapter on Social Security. Chapter 2 will give you the five deadly assumptions that follow from the implications of this chapter.

I have made another change. In earlier editions, I did not include footnotes. In this edition, I must. The facts I present will seem incredible to some readers. Perhaps they will not trust me initially. I have included the sources of my statements in order to allow skeptics the opportunity to check out everything I have said, point by controversial point. People who need no convincing can, if they choose, ignore the footnotes. Never allow yourself to be intimidated by the sight of footnotes. They are supposed to be there to help you make better conclusions.

The Illusion of Security

I first learned of the problems facing Social Security in 1958. My high school civics teacher, Mr. Wayne Roy, was a rarity: a card-carrying conservative in a southern California public high school social studies classroom.[1] He briefed us on the economics of the

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1. Mira Costa High School, in Manhattan Beach. He has taught down the road at Redondo Union High School in Redondo Beach since 1959, and he is still giving fits to local liberals. That school has what is probably the most conservative social studies department of any public school in California. It was the one school in southern California, literally, from 1965-70, which maintained dress codes and did not experience riots, although sociologists would probably regard the school as lower middle class. Ideology and leadership, not economic class, made the difference. Its

whole program. Then he invited the local Social Security public relations man to drop in and "explain" the system to his classes. For five hours, the man was grilled unmercifully, class after class. I can still remember that man, a quarter of a century ago, trying without success to answer the hard-nosed economic questions of carefully briefed 17-year-old seniors. He did this for several years in a row. Eventually, the poor man gave up and quit working for Social Security. He later told Mr. Roy that in the whole district, his students were the only ones who had been prepared to ask the hard questions. Social Security finally stopped sending anyone out to lecture to his students.

My second encounter with the reality of the program was in 1963. I had just graduated from college, and I was in a graduate program. One of the other students told me that his older brother had been an actuarian (statistician) for the Social Security Administration. He had examined the figures carefully. He then resigned, went back to Nebraska, and joined the John Birch Society. I knew there was a problem brewing.

The Social Security program, if offered for sale to the public by a private, profit-seeking businessman, would be shut down by the government as a fraud. It would be classified as a "Ponzi scheme." Charles Ponzi was a con artist in the 1920s who invented a unique program. He would tell people that he would pay them a huge return on their investment within a few months. Then he would take their money and pay off the previous investors. It looked terrific to those who invested early. Sooner or later, however, such promoters run out of new investors, and they have to default on their obligations (promises) to the investors who have not yet been paid off. Predictably, many of those who get involved early become greedy and try to cash in on a "sure thing," so they reinvest their money in the program. They lose everything they made, plus their original investment.

You might look at it from another angle. Bobby Gold did. He wrote this little parable for *Parade Magazine* (March 28, 1976):

> Social Security is a wonderful plan. People say it's going bankrupt. Don't believe them. It works. I know. My uncle reached 65 and he sent in

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most famous graduate was Lynnette "Squeaky" Fromme, who was a Manson cult member and who tried to shoot President Ford. But she was a quiet high school student.

the appropriate forms. In a week he received a wonderful letter: "Dear Mr. Gold. Welcome to the Social Security System. Attached is a list of ten names. Just send $100 to each name on the list and retype up a new list with your name at the bottom. But remember, don't break the chain!"

Pretty funny, right? Problem: it is Bobby, not his uncle, who is told not to break the chain. The workers who are under Social Security—and this means every American except those fortunate few who work for the Federal government (including Social Security's staff),[2] some state and local governments, and non-profit institutions not covered by the program—pay into the scheme each time they receive a paycheck. They "put their names at the end of the list," and they hope that when they retire there will still be people who are "signing up for the opportunity of a lifetime." There won't be. There never are. The suckers eventually catch on.

Unlike a true chain letter, those who receive it are not allowed to break the chain. The government has made it a crime to stop paying into the Social Security system. People who refuse to pay will be prosecuted. (Or at least, this is what we are all told. Certain tax resisters argue that there are legal though somewhat risky ways to escape, but not many people have listened . . . yet. If they do begin to listen, the chain will be in even bigger trouble—and it is in deep water right now.)

A chain letter is illegal because it is a form of gambling. People know the scheme cannot go on forever, but they hope that they will get on the magic list early enough so that new suckers are still being signed up before the list gets too long for all the latecomers to be paid off. Everyone wants to be an early bird. Most people wind up pigeons. Like any chain letter, the scheme breaks down when the promoters run out of gamblers. The whole game is built on one premise: the greater fool theory. There will be more fools to sign up after I do. I hope.

Look at the statistics. In 1935, the New Deal began this chain letter. The most revealing account of the origins of this program is the obscure biography of Social Security's equally obscure (but crucially important) intellectual founder, Wilbur J. Cohen, written by Dr.

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2. Workers who worked first for the Federal government and who then get jobs in private industry do pay into the system, but they also get Social Security pensions, plus their Civil Service pensions, upon retirement. This is called "double dipping." In 1975, at least 44% of retired Federal employees were receiving Social Security payments: *New York Times* (Nov. 25, 1977). By the time you read this, formerly exempt workers may have been forced into the system.

Marjorie Shearon, who worked as a statistician with the Social Security Administration from 1936 to 1941. She calls her five-year experience inside the program "a prolonged course in State Socialism."[3] It signed up millions of people who were happy to get into the scheme early. The total tax rate was 1% of earnings on the first $3,000, or $30. Actually, the worker paid up to $30, and his employer matched his "contribution." ("Contribution." Isn't this a wonderful word for a tax? It almost makes it sound like a true insurance scheme. It isn't.) The combined rate was actually 2%. It stayed at this level until 1950. The money rolled in: lots of workers, not many retirees. There were just under 5 million Social Security beneficiaries in 1950.[4] This was the "insider's" phase of the Social Security chain letter. By 1975, there were 29 million beneficiaries.[5] By 1979, there were 35 million.[6] The snowball just keeps on rolling.

The money went into the Social Security "trust fund." This is another clever phrase. Actually, the money was used to buy government bonds.[7] The money was promptly spent—what government money isn't? The "trust fund's" assets, in order to be spent on the beneficiaries, must be first sold back to the U.S. Treasury—cashed in for paper money. Of course, the government bonds draw interest. Guess where the money to pay the interest comes from? Right: from you and me. It comes in from tax money, or from receipts from the sales of more government bonds or other government-owned assets, or from newly printed fiat money. There is no fourth source. So the trust fund is only a government promise to pay. Let's look at how good that promise has been kept. Let's look at the size of the "trust

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3. Marjorie Shearon, *Wilbur J. Cohen: The Pursuit of Power* (self-published, 1967), p. v. Dr. Shearon later became a consultant with Sen. Robert A. Taft. Cohen coauthored the introduction to Edwin Witte's confidential in-house memorandum on the legislative history of the program, *The Development of the Social Security Act* (Madison: University of Wisconsin Press, 1962). It was no accident that Cohen was invited to write that introduction; he was one of the central players.

4. *Demographics and Inflation: Cause for Concern Over Retirement Income Policy* (Washington, D.C.: Employee Benefit Research Institute, 1980), p. v. Address of EBRI: 1800 M St., N.W., Washington, D.C., 20036.

5. *Ibid.*, p. v.

6. *New York Times* (July 17, 1979).

7. *Social Security Trust Fund Investments: Policies and Practices,* Subcommittee on Social Security of the Committee on Ways and Means, U.S. House of Representatives, Oct. 13, 1981 (Washington, D.C.: Government Printing Office, 1981). About 90% of the fund is invested in long-term (average maturity: 7 years), nonmarketable, "special issue bonds," p. 8. The "managing Trustee" who decides where to "invest" the fund is the Secretary of the Treasury: p. 8.

fund."[8]

Year	Assets (billions)
1950	$13.7
1955	21.7
1960	20.3
1965	18.2
1970	32.5
1971	40.4
1972	42.8
1973	44.4
1974	*45.9*
1975	44.6
1976	41.1
1977	35.9
1978	31.7
1979	27.7
1980	24.6
1981	23.8

The year 1974 was the high point. Since that time, the fund has shrunk every single year, despite the huge increases in Social Security taxes after 1977 (the year the first edition of this book was published). Today, the Old Age Survivors' Fund is empty. In 1947, there was enough money in the fund to pay beneficiaries for 17 years.[9] By 1975, it had fallen to nine months.[10] It has gone downhill since then. As the 1981 staff report of the House Ways and Means Subcommittee on Social Security warned, the combined assets of the three trust funds in 1981 "represented about 23 percent of expected outgo during the year—or about 3 months' worth of benefits. In order to have trust fund reserves at or about this level (specifically, at 20 percent of one year's outgo) by the beginning of 1986, about $17

8. These statistics appear in Table I, Chapter II, in the ERBI study, *Pensions and the Economy* (review draft, 1982).

9. The best recent study of the Social Security system is Peter Ferrara's book, *Social Security: Averting the Crisis* (Washington, D.C.: Cato Institute, 1982). Address: 224 - 2nd St., S.E., Washington, D.C. 20003. This is a shorter version of his excellent study, *Social Security: The Inherent Contradiction* (1980), also published by the Cato Institute.

10. Warren Shore, *Social Security: The Fraud in Your Future* (New York: Macmillan, 1975), p. 10. This is still a useful book, but the crisis has accelerated so much since its publication that it is badly outdated. Ferrara's books are more comprehensive, more scholarly, and more recent.

billion of added income to the system would be needed under CBO [Congressional Budget Office] assumptions. As much as $80 billion would be needed under the Administration's 'worst-case' scenario. Even larger amounts of income would be needed if a more adequate reserve margin were desired."[11]

The empty trust fund is significant politically; it is not that significant economically. It had been full of "special" (unmarketable) government bonds. The Social Security Trustees took in the tax money ("contributions"), bought government bonds, and the Treasury then spent the money to finance any and all Federal programs. *The trust funds are nothing more than accounting devices to delude the voters.* Since 1974, the Trustees have been forced to sell bonds back to the only possible buyer, the Treasury. So the Treasury had to come up with the cash to redeem the bonds—at par (face) value, by the way,[12] despite the fact that interest rates were rising throughout the 1975-82 period, and "real" bonds, meaning bonds that are bought and sold in the open market, were declining in value. This was a very curious accounting game. Where did the Treasury get the money? Where else: from the general fund. Problem: the U.S. budget has been in the red for two generations. In other words, the deficit in the Social Security system has been paid for by the deficit-plagued general fund all along. Now, however, the accounting technique no longer covers up the true nature of the "game." The trust fund accounting swindle has ended.

The politicians are petrified. There is now no politically acceptable way to bail out the system openly (higher visible taxes), or to let it go into default openly. The politicans need a new, improved accounting swindle, now that the trust fund swindle is over. What I am predicting here, and what a more candid politician (Senator William Proxmire) has admitted, is this: *the politically acceptable accounting swindle is monetary inflation.* Create the money and send the recipients the checks. But won't this force up prices? Yes. But won't rising prices push the cost of living indicators higher? Yes. Then monetary inflation isn't enough to fool the public; the politicians need

11. *Social Security Trust Fund Investments: Policies and Practices,* Subcommittee on Social Security of the Committee on Ways and Means, U.S. House of Representatives, Oct. 13, 1981 (Washington, D.C.: Government Printing Office, 1981), p. 21.

12. *Ibid.,* p. 9. Because the Treasury had to pay off the bonds at face value, unlike all other government bonds, they were "nonmarketable"—not sold to the public.

monetary inflation and price controls, to freeze the cost of living index. Right. Will they do it? Count on it.

The year the Old Age Survivors Insurance (OASI) trust fund went into a deficit for the first time, 1975, Ida Fuller died. You have never heard of Ida Fuller, but Ida Fuller was the living (and dying) example of the built-in flaw of the Social Security program. Ida Fuller received her very first Social Security check, issued by the United States, on January 31, 1940. Thirty-four years and $20,000 in retirement benefits later, she died at age 100. Her total "contributions" to the program: $22. Her first check, $22.54, matched her total "investment" in the program.[13] She was among the first to start collecting from the chain letter. She got in early, and the money flowed in. Now the money is flowing out.

We are on the far side of this chain letter. The birth rate since the late 1950s has fallen dramatically, from slightly under four children per woman to under two children. But if the supply of new players is going to drop over the next forty years, what happens to those taxpayers who have to keep the chain letter going? It is estimated that if the present birth rate prevails, in the year 2025, there will be over 60 retirees receiving benefits for every hundred workers, double today's figure of 30 retirees.[14] Ferrara's study reports that official estimates by the Social Security Administration in 1982 of the tax consequences of Social Security's old age and disability program in 2030 indicate that payroll taxes will climb to at least 22%, up from about 13% in 1982. Ferrara estimates that this figure is misleading, since the program involves other expenditures, such as health insurance, in addition to old age and disability payments; anything from 25% to 33% of their pay will be needed to keep the total System going.[15] This, you understand, is in addition to state and local taxes, and on top of personal and corporate Federal taxes for everything else besides Social Security. As he says, "these official projections fail to take into account the negative economic effects likely to be caused by such high social security tax rates themselves. It seems likely that a payroll tax rate of 25 percent or more will greatly discourage employment. Savings and capital investment are also likely to be further discouraged . . . leading to fewer jobs, higher unemployment, and lower real-wage growth. The result is that revenues will

13. *Los Angeles Times* (Jan. 28, 1975).
14. Ferrara, *Averting the Crisis,* p. 57.
15. *Ibid.,* pp. 59-60.

not be increased as much as expected from these high tax rates, and these rates will therefore have to be raised further."[16] His conclusion? Simple: *taxpayers will be unlikely to pay these taxes.*

The National Taxpayers Union, a Washington lobby which pushes for a balanced budget, estimated in 1982 that future Federal pension liabilities, which include Social Security, are now rising at an incredible rate of $1.65 billion *per day.* In other words, if we look at the life expectancy of the people enrolled in the program, and compare this with the political life expectancy of the pension programs, we can easily see which are going to die first. I will put it more bluntly: the Social Security system will be scrapped, or drastically modified, long before 2030. More to the point: *the dollar is going to die before the people do who are owed the pension fund money.*

Costs

In 1938, Ferrara reports, total expenditures were $10 million. They climbed to $38.4 billion in 1970, and in 1981, expenditures reached a staggering $175.1 billion. This makes it the largest compulsory social welfare program in the world. By 1981, Social Security expenditures constituted over one quarter of the total Federal budget.[17] The 1983 expenditures may hit $200 billion. The Social Security tax collected more funds than the corporate income tax—second only to personal income tax receipts.

Who pays this tax? Legally, the employer and the employee. Economically, the *employee* pays virtually all of it. The employer really does not care where the money goes, to the employee or to the Federal government. It costs him wages (including fringe benefits) plus Social Security taxes to hire the worker. Both payments are deductible expenses. If he did not pay the money to the government, the worker could easily ask for the money and get it; that is what he is worth to the employer.[18] Because of the tax, the worker is not receiving the full value of his services to the employer, and therefore to consumers. The greater the gap—or wedge—between what a worker is worth and what he receives in take-home pay, the fewer the number of potential laborers who will work.[19] More of them will

16. *Ibid.*, p. 60.
17. *Ibid.*, p. 2.
18. *Ibid.*, p. 8.
19. *Ibid.*, pp. 28-31. The concept of the "wedge" was popularized by Prof. Arthur Laffer of the University of Southern California, the creator of the "Laffer Curve."

go on welfare, since welfare payments are not taxed.

As of 1982, the combined tax rate—employer and employee—was 13.4% of the first $32,400 of income, or a maximum tax of $4,341.60. This is up from $60 per year in the 1935-49 period. Based on projections of the Social Security Administration, in the *1982 Annual Report of the Board of Trustees,* the maximum tax will climb to about $8,700 per year per wage-earner.

But, you may be asking yourself, who pays the maximum tax rate? The average worker does not earn anything like the maximum possible. In today's world, that is true, but what if we get more inflation? What if the wages of workers, as denominated in paper money, keep rising? Then, step by step, the whole population is pushed into the maximum income brackets. Furthermore, with both marriage partners working, it is not hard to imagine what will happen. The more the inflation continues, the higher will be the family's taxes.

If you don't think either a political rebellion or a tax rebellion is coming, you are asleep at the wheel.

The Deficit

To protect the recipients against the effects of rising prices, the government passed into law a complicated system of indexing: higher prices lead to higher Social Security payments. But higher payments have led to a greater drain of funds—far higher than receipts from the Social Security tax. The recessions of 1974-76 and 1980-82 led in both instances to temporarily higher prices (interest rates especially), higher Social Security payments, and higher unemployment. Unemployment led to a reduction of the growth of tax receipts. Thus, modern "stagflation" increases the gap between tax receipts and indexed expenditures. The deficit grows worse.

The government's representatives have not always been forthright in admitting these problems. The Social Security's Board of Trustees put this bit of fluff into the *1978 Annual Report:*

> The Social Security Amendments of 1977, enacted on December 20, 1977, restore the financial soundness of the cash benefit program throughout the remainder of this century and into the early years of the next one.[20]

President Jimmy Carter answered a question about Social Security

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20. Social Security Board of Trustees, *1978 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (Washington, D.C.: Government Printing Office, May 15, 1978), p. 3.

in his 1980 presidential debates:

> [A]lthough there was a serious threat to the social security system and its integrity during the 1976 campaign and when I became President, the action of the Democratic Congress working with me has been to put social security back on a sound financial basis. That's the way it will be.[21]

Either Mr. Carter was lying, or else he had not heard from Dr. Alice Rivlin, the head of the Congressional Budget Office. On August 6, 1979, buried deep on page D9 of the *New York Times,* was an article on a report that Dr. Rivlin wrote to Cong. Robert Gaimo, the head of the House Budget Committee (a Democrat) to warn him that "there could be a significant deterioration in the financial soundness of the Social Security system during the next five years." She predicted that by 1984—good old 1984—the Social Security trust fund could be down to 5% of annual outlays. As of late 1982, the trust fund was down to about 0% of annual outlays, which makes Dr. Rivlin a much better forecaster than either the so-called Trustees or "I'll Never Lie to You" Jimmy. She also seems to have been a better forecaster than all the professional actuaries working for the Social Security Administration, who had confidently predicted in 1977 that if Congress passed the new tax increase, the fund would rebound to 49% of annual expenditures by 1984, after hitting a low point of 26% in 1981.[22]

Gerald Ford's administration had done its best to misinform the public. The headline in the *Wall Street Journal* (May 6, 1975), announced: "Short-term Rise in Social Security Tax Won't Have to Be Big, White House Says." The Ford Administration had simply lied: the senior actuary of the Social Security Administration had warned many months earlier that a huge increase in the Social Security tax was mandatory—50% to 75%—to keep the scheduled benefits coming.[23] Everyone knew the truth. "U.S. Benefits: Trust Funds Running Out" screamed the *Los Angeles Times* (Feb. 22, 1975); "Ebbing Resources: Social Security System on Its Way to Going Broke, Analysts Warn," said the *Wall Street Journal* (Feb. 27, 1975); "Social Security is Broke" said the conservative columnist Dan Smoot (*Review of the News,* May 14, 1975). The increase had to be big, and it was: the largest single tax

21. *New York Times* (Oct. 29,1980); cited by Ferrara, p. 61.
22. *New York Times* (Oct. 6, 1977).
23. *Los Angeles Times* (Sept. 1, 1974).

increase in U.S. peacetime history (as of 1977), $227 billion. It didn't work.

You will be happy to learn, I am sure, that the payroll taxes already imposed, and scheduled to come throughout the 1980s, are really not so bad. That word came to us from the then-Acting Commissioner of Social Security, Don Wortman. "I've never quite understood this reaction, and I think some of you folks in the media had something to do with it. . . ."[24] He was replaced a few months later by a permanent Commissioner, Stanford G. Ross, a former White House aide to Lyndon Johnson.

Ross was also unconcerned with the level of taxes. When asked by a reporter if he favored rolling back Social Security taxes, he replied emphatically: "Absolutely not. . . . In voting those increases, Congress demonstrated the courage of its conviction that this is an important social system for our country and that its financial integrity must be preserved—even in a time when the public is against tax increases." In short, the taxpayers be damned. He was asked, "Is there any danger that people will not get the old-age pensions they are expecting?" His reply: "No, I don't believe there is any chance of that." And finally, to show that he was no second-rater when it came to misinforming the public about Social Security, he assured us, "There is a long-term financing problem projected somewhere after the next 50 years. But it's not an issue which requires any immediate action."[25] Six months later, he told Congress that changes were mandatory in the system, and that "painful adjustments" would have to be made, and discussed the "limitations of Social Security." He even talked about raising the retirement age above 65.[26] Then he retired, returning to his law practice. In early 1980, as a private citizen once again, he called for the creation of a new Federal agency, the "Department of Income Security," which would "carry the message of the need for greater individual and collective responsibility to the people."[27] Mr. Ross saw exactly what is coming: the bankruptcy of the chain letter. He wisely cut and ran.

The Social Security trust fund as of November, 1982, is extinct, as I had predicted it would be in earlier editions of this book. The

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24. "Social Security Chief Says Tax Hike Not So Bad," Associated Press story, *Durham Morning Herald* (March 26, 1978).

25. "Does Social Security Need an Overhaul?" *U.S. News and World Report* (Jan. 8, 1979).

26. *New York Times* (July 17, 1979).

27. Stanford G. Ross, "On Income Security," *New York Times* (April 28, 1980).

Trustees warned on April Fool's Day, 1982, that it could be empty by July of 1983.[28] They had made this same warning in 1980, assuming the economy went into a recession, which it did.[29] Now that the trust fund finally is empty, there could be a major political crisis. The reality is now obvious to far more voters: the system is bankrupt. Will the Congress hike Social Security "contributions" (taxes) once again? The 1977 increase was supposed to guarantee the solvency of the trust fund for the remainder of this century; it did not survive the deficits of 1977-82. How will Congress explain the need for another massive tax hike? And how will the economy survive if such a hike is imposed? But if there is no tax hike, how will benefits be paid? The government will "tap" the general fund. Problem: there is no general fund to tap. What there is, and all there will be, is a massive Federal budget deficit. So they will print the money.

Let's be realistic about the empty trust fund. It was always empty. It had only a pile of government bonds in it. The money was spent on other government projects years ago. The government took the tax ("contribution") money, issued unsalable bonds to the trust fund, and then spent the money. But the *illusion of solvency* of the system was maintained by the presence of the phony trust fund. Today, the government can no longer maintain the illusion. (Most of what this book is about is the illusion of Federal solvency, the game—actually, the war—which the politicians play on the voters. To a great extent, your economic future will depend on how well you respond to this political game.)

This crisis is worldwide. All major Western nations have made these same political promises to retired people, and all of the social security programs are close to bankruptcy. Even Japan is caught.[30] In fact, the breakdown of any one system threatens the solvency of all the others, for the political and economic reaction in any given nation could affect the overextended international banking system.

In early January of 1978, I was frantically revising the page proofs

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28. The *1982 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Fund* (dated April 1) makes this July, 1983 estimate: House Document 97-163 (Washington, D.C.: Government Printing Office, 1982), p. 70. This was reported by the *New York Times* (May 2, 1982).

29. *New York Times* (June 20, 1980).

30. Lawrence Chickering, "The Social Security Problem: We've Got Company," *Wall Street Journal* (May 20, 1982).

for the 1978 edition of this book. The 1977 Social Security tax increase had been passed into law two weeks earlier. I made a prediction about the Federal deficit in 1984—a prediction that seemed preposterous then. Let me quote directly from pages 11-12:

> The tax increases necessary to fund this deficit—whether $2 trillion, $7 trillion, or the possible "uncoupled" $8-$10 trillion—are enormous, as the bill signed into law in 1977 indicates. It may well be the largest long-term tax increase that any single piece of legislation has proposed in this nation's history. The President immediately proposed a $25 billion tax cut to make up for the increase in Social Security taxes, since these taxes could quite easily trigger a major recession. But if tax cuts are voted, then the whole Federal deficit, which includes Social Security, is right back where Dr. [Rita Ricardo] Campbell says it is. The deficit will have been transferred out of Social Security and into the general fund. The only way a government can fund such massive deficits is through the creation of fiat money. If that happens, pensions will not amount to much anyway. The purchasing power of the monetary unit will be reduced to a fraction of its present value—and its present value is not much to brag about. . . .
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> By keeping the deficit out of the Social Security system and lowering taxes generally, the deficit is simply transferred to the general fund. What is the economic meaning of this? (The *political* meaning should be clear: no one is willing to take a stand against Social Security, and the public has to be made to believe that the program is in good shape financially, a true retirement program, in other words. It is not that politicians are somehow afraid of Federal deficits; they are afraid of deficits inside a program which is supposed to be sound by private insurance fund standards—or at least provide the illusion of being sound.) The general fund runs annual deficits of $50 to $70 billion. An increasing portion of this deficit will have to be funded by the creation of money through the Federal Reserve System. No one objects to deficits in the general fund, so increasing oceans of fiat money are therefore close to inevitable. To compensate for the astronomical increase in Social Security taxes scheduled over the next decade, the annual Federal deficits will begin to approach $100 billion a year. I believe that a $200 billion deficit is a realistic projection for fiscal 1984.

This was, essentially, a critique of the so-called "supply-side economics" experiment: the attempt to lower general tax rates in order to get the economy rolling again. I did not believe that the experiment would work, since it leads politically to more monetary expansion and more price inflation. It did not matter whether Democrat Carter or Republican Reagan launched such an experiment; it had

to fail.[31] The experiment could lead only to greater deficits, meaning more inflation or a recession, or both; the political-financial obligations of the Federal government are too great to be met without massive budget deficits. Nothing will work except cutting tax rates, and cutting expenditures enough to run a Federal surplus. (I think anyone who calls for only a balanced Federal budget is "squishy"; we need a generation of surplus budgets, with the surpluses to be used, year by year, to reduce the Federal debt to zero, the way it almost was back in 1916. It is not going to happen in this fashion. The debt will be "paid off"—repudiated—with fiat money, which is what this book is all about.)

The more forthright members of the Congress and the Social Security Administration have admitted this. They know what is coming. The public is also catching on. The cold-blooded ruthlessness of the plan is nevertheless more than most voters would believe. I daresay most of the readers of this book will be shocked to read the following exchange of opinions, which took place in 1976, between Senator William Proxmire and the then-Commissioner of the Social Security Administration, James Cardwell. I am reproducing this exchange word for word. It has to be read to be believed.

PROXMIRE: ". . . there are 37 million people, is that right, that get social security benefits."

CARDWELL: "Today between 32 and 34 million."

PROXMIRE: "I am a little high; 32 to 34 million people. Almost all of them, or many of them, are voters. In my State, I figure there are 600,000 voters that receive social security. Can you imagine a Senator or Congressman under those circumstances saying, we are going to repudiate that high a proportion of the electorate? No.

"Furthermore, we have the capacity under the Constitution, the Congress does, to coin money, as well as to regulate the value thereof. And therefore we have the power to provide that money. And we are going to do it. It may not be worth anything when the recipient gets it, but he is going to get his benefits paid."

CARDWELL: "I tend to agree."[32]

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31. Gary North, *The Last Train Out* (Ft. Worth, Texas: American Bureau of Economic Research, 1983), Pt. I.

32. *The Social Security System,* Hearings Before the Joint Economic Committee, Congress of the United States, 94th Congress, 2nd Session, May 26 and 27, 1976 (Washington, D.C.: Government Printing Office, 1976), pp. 27-28. The discussion took place on May 26.

Any reader who does not take this candid admission seriously is asking for a personal financial disaster. The ground rules are clear: *the politicians will destroy the dollar when it becomes necessary to save the illusion of solvency of the Social Security system.* The Federal Reserve System, our nation's central bank, will cooperate with them in this "noble" effort. And when they do it, it will wipe out virtually all private, dollar-denominated pension and annuity programs.

James Cardwell was candid even in retirement. He retired from his \$50,000 a year position in late 1977. He began to receive a \$24,000 a year pension—before inflation indexing. He then took a \$53,000 a year job with the Corporation for Public Broadcasting. He candidly admitted that he thought it was a mistake for the Federal government to make his retirement so easy, even after 35 years of service. He said he wished that he would not have to pay into Social Security in his new job—he had never been under the system before—because he did not expect to spend eight and a quarter years in the job, which would make him eligible for Social Security pension money. He said he did not believe in "double dipping"—pension money from both Social Security and Civil Service—so he wished he did not have to get involved in Social Security at all.[33] Social Security's propaganda about all the wonderful benefits of the program had trapped him: the Corporation for Public Broadcasting, a non-profit organization, never was required to sign up with Social Security, but its officials had decided to get in. Meanwhile, state and local government workers were beginning to pull out.[34] The ironic result: ex-Commissioner Cardwell had to pay Social Security "contributions," just as the rest of us have to pay, with little hope of collecting anything, also like the rest of us.

The "Sting"

The cost to voters of this monstrosity is not simply the threat to the purchasing power of the dollar, not just the threat of a political and

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33. *New York Times* (Nov. 26, 1977).

34. *Termination of Social Security Coverage: The Impact on State and Local Governments,* a working paper prepared by the Select Committee on Aging, United States Senate, Sept., 1976 (Washington, D.C.: Government Printing Office, 1976). See also "Social Security System Faces New Strains: Withdrawals by Local Government Employees Undermine Financing," *Los Angeles Times* (May 25, 1976). "Anti-Social Security: Employees of State and Local Governments Are Opting Out," *Barron's* (March 8, 1976). "Alaska's Employees Quit Social Security," *New York Times* (Sept. 22, 1979).

economic revolution which the breakdown of the welfare State will produce. The cost, irrespective of inflation, is the incredible theft involved in the program.

Peter Ferrara has sketched some of the costs. What if a 24-year-old man or working woman begins to set aside money for retirement when he or she enters the work force? Given the worst set of assumptions made by the administrators of Social Security—the assumptions that almost always are those that eventually prove to be closer to the mark—and given a 6% per annum compound after-tax, non-inflationary return on investments, what if the young person starts saving the money that would have gone into the Social Security chain letter? Assume three possible earning levels: the maximum income to which the presently scheduled Social Security taxes apply, the average income worker, and a lifetime minimum wage worker.

Under our selected assumptions, our maximum income worker would retire at age sixty-five with a retirement trust fund of $995,320 in constant 1980 dollars, or approximately $1 million. This fund could pay the worker $59,719 in constant 1980 dollars each year out of the interest alone. This would allow the worker and his spouse to enjoy this annual income until both died and still leave the million-dollar fund to their children. Alternatively, the worker could use the fund to purchase an annuity that would pay $96,939 annually in constant 1980 dollars until he or his spouse died, and $64,626 until the surviving spouse died.

Social security would pay this worker $23,326 each year in constant 1980 dollars until he or his spouse died, and $15,551 until the surviving spouse died. In addition, social security would provide hospital coverage worth $1,000 per year for each spouse while alive. Social security, of course, never leaves the worker with a trust fund to pass on to his children. Thus the private system could pay this worker about four times what social security would pay, or alternatively, it could pay well over twice what social security would pay while still allowing the worker to leave approximately $1 million to his children. Furthermore, if both the worker and his spouse worked as professionals and both earned the maximum taxable amount, the trust fund amount and benefits paid under the private system would double. Social security benefits, however, would remain the same except that the annual benefit paid while both spouses were alive would increase by one-third, to $31,102.[35]

35. Ferrara, pp. 45-46.

The numbers may seem incredible. The effect of compound interest presumably cannot go forever—not without mass inflation, anyway. Also, few couples today would have such a financial experience as maximum earnings for both from age 24 to 65. But what about the average income worker? Ferrara's calculations produce a remarkable figure: a trust fund of $469,662, which would pay the man $28,180 per year in interest alone. The private system, he calculates, would pay about three times as much as the Social Security system would, or pay twice as much, but allow the man to leave almost half a million dollars to his children. And what of the low-income worker? He would get a trust fund of $287,798 in constant 1980 dollars, or $17,268 a year from interest, or an annuity of $28,030 for both until the death of one spouse, and $18,687 until the survivor died. This means that, even counting medical expenses, the private system would pay the minimum wage worker three times what he will receive from Social Security, or 50% more while allowing him to pass along over a quarter million to his children.[36]

Naturally, it can and has been argued that people will not invest wisely, or invest at all, and Social Security forces them to be thrifty.[37] But this argument is exploding under the noses of its proponents: the entire compulsory system is steadily going bankrupt. Instead of leaving less thrifty people in poverty in their old age, this compulsory, so-called insurance scheme is about to bring almost *everyone* into poverty because, in order to preserve the illusion of the program's solvency, the purchasing power of the dollar will have to be sacrificed.

Things are even worse than they appear. Americans, confident that they are going to be protected in their old age, invest anywhere from 37% to 40% less than they otherwise would have, according to Harvard professor Martin Feldstein, who served as the director of the prestigious National Bureau of Economic Research before he became the chairman of the President's Council of Economic Advisors in the summer of 1982.[38] This forfeited private investment has cost America a fortune. Again, citing Ferrara:

The importance of the loss of this enormous amount of capital investment

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36. *Ibid.*, p. 46.

37. This and other justifications for compulsory insurance are dealt with by Ferrara, ch. 9.

38. Feldstein's studies are summarized in Ferrara, pp. 22-24.

can be seen in the impact of this loss on national income and economic growth. With less capital, less of the nation's resources are devoted to production and to the materials necessary to increase that production. The result is less production and lower levels of national income and economic growth. By Feldstein's calculation, if social security reduces savings by 35 percent, then the long-run capital stock without social security would be 80 percent higher than it is today. With this additional capital, Feldstein calculates that GNP [Gross National Product—G.N.] would be 19 percent higher each year. In 1981, then, in the absence of social security, GNP would have increased by $550 billion. This was about 30 percent of total consumer spending in that year, almost twice the total of individual income tax payments and substantially more than three times the level of national defense expenditures. It amounted to $2,400 per person and $6,600 per family. Over the five years from 1977 to 1981, this aspect of the program alone needlessly cost the American people over $2½ trillion in lost GNP. This total amounted to approximately $10,000 per person and $27,000 per family.[39]

The Dependence Factor

There are many reasons why Social Security is a bad program. First, it is fundamentally a program which would substitute the bureaucratic State for children. The Bible says, "Honor thy father and thy mother" (Exodus 20:12). This means, among other things, that children are financially responsible for elderly parents. But the State wants to become both parent and child, to offer free educations for children (and control the content of that education) and to care for the elderly. The State becomes an *imitation family,* and all members are called upon to support the State, just as they would defend and support parents and children.

Another reason why Social Security is a bad program is its compulsory nature. People eventually begin to resent compulsion. When they do, they begin to resent the State. They even begin to resent the recipients of State welfare money. In the case of Social Security, this means the helpless aged.

Third, as we have seen, it is a program that is not checked by economics. It is checked only by politics. Thus, to stop its expansion, politicians must challenge a powerful voting bloc, the elderly. They are too fearful to do this. Thus, it creates guilt among the taxpaying public, and leads, eventually, to the "hidden" repudiation by mass

39. *Ibid,* p. 25.

inflation and (as I shall show) price controls. No one has the courage or the votes to stand up against the system openly. To escape this huge tax, a worse tax must be imposed on the elderly: repressed inflation, or the price control system.

The fourth feature that is so terrible is the dependence factor. *People begin to trust the State,* which is dangerous and ultimately suicidal. They lose their freedom and independence as a result, and then, when the State goes bankrupt, they find themselves worse off than ever. A little booklet published by the Employee Benefit Research Institute spells out in detail: "In 1950, only 20 percent of elderly households received Social Security benefits and less than 10 percent received employer pension benefits. In 1980, over 90 percent of elderly households received Social Security and over one-third received employer pensions. Additionally, the average real Social Security benefit has increased by a factor of three since 1950. The average real employer pension benefit has also increased. While Social Security and employer retirement programs have increased in importance relative to other sources, the role of employment income has declined. Presently, only 20 percent of men age 65 and over are working."[40] Price controls will wipe out the purchasing power of both kinds of pensions: government and private. Meanwhile, 80% of men age 65 and over have left the visible workforce. They face a calamity unheard of in 1935. In fact, prior to 1935, there was no universally agreed-upon age for retirement. That arbitrary age limit came into use as a direct result of Social Security, and those in the Social Security Administration who made the decision had done no research on the relationship between age and productivity.[41]

Men have become dependent on an unreliable source of income, the State. In the Bible's words, they have leaned on a broken reed (Isaiah 36:6). James Cardwell, before he retired as Chairman of the Social Security Administration, put it this way: "Where it comes out is this: Everybody's got to hold onto that ledge just a little longer. It's 20 stories below and you're dead if you fall. So you just hang on as long as you can."[42] Problem: the ledge itself is about to collapse.

Can the System be Salvaged?

There are a lot of proposed solutions around, the main one being

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40. *Retirement Income Opportunities in an Aging America: Income Levels and Adequacy* (Washington, D.C.: Employee Benefit Research Institute, 1982), p. 4.

41. *Washington Post* (Sept. 5, 1976).

42. "Social Security: U.S. Umbilical Cord," *Washington Post* (March 28, 1977).

the one Barry Goldwater went down to defeat with in 1964: allowing people to escape the system by setting up their own privately funded retirement programs. This solution is all theory and no political substance. The function of the Social Security system is not to help people fund their retirement. *The function of Social Security, and all other compulsory, tax-financed welfare programs, is to create total dependence on the State.* Because Social Security's critics, mostly economists, have not faced up to this, they continue to offer fine theories about how the State can "meet its obligations to the poor," while avoiding compulsion. It cannot be done. It will not be done. The system is headed for disaster. Politically, there is no escape short of a moral, religious, and political revolution—a revolution of the mind and spirit. Don't bank on it.

But can the system be saved within the framework of "moderate socialism"? Here are the only possibilities open to the government. First, raise the taxes of every worker who is covered by Social Security, and hope that there will be no political revolt or taxpayer rebellion. This is what the government tried in 1977. It was supposed to last until well into the next century. The "reform" did not survive the decade. The American taxpayer is overburdened now; more taxes will only lead to reduced employment (leisure, after all, isn't taxable), less output, and a massive tax resistance movement. The welfare State is at the end of the road. There are no more "quick fixes" available.

Second, the government can print up the money (create it in the computers) and allow everyone's monetary income—nominal income—to increase. This will push everyone into higher tax brackets. (Yes, despite the minimal indexation of taxes passed in the 1981 tax reform bill. The indexation clause will probably be repealed; in any case, it is only partially effective as presently designed.) This, too, is socialism. Inflation increases the pay-outs for Social Security pensions, Civil Service pensions, and other Federal pension programs. (The most generous, predictably, are the pensions paid to retired congressmen and senators.) This increases the deficit. It requires more monetary inflation to meet the deficit, which forces prices higher, which makes the deficit worse. . . .

Third, the government can create the fiat money, mail out the checks each month, and freeze prices and wages. This will freeze the legal, official cost of living indicator, thereby freezing the paper money incomes of all pensioners.[43] This will destroy the legal

43. See Chapter 3: "Shutting Off the Cost of Living Escalators."

markets, and create huge black markets, which will be very risky and very expensive—too expensive for the vast majority of pensioners. The result will be shortages on the legal, visible markets. This is called *repressed inflation,* and is another form of socialism. It will require government rationing.

In other words, to salvage the Social Security chain letter, the government will be forced to accelerate the pace of socialism in the United States. This means a falling level of productivity and a falling standard of living. As the wise man once remarked, "You can't redistribute it if there ain't any."

There are other solutions. No less a liberal source than the editors of the *New York Times* proposed that the minimum retirement age should be raised, and that Social Security payments should be taxed, and that future payments be frozen. They admitted the truth: "Social Security is on a collision course with reality" (Sept. 4, 1979). But such solutions do not confront the political realities of the problem: no politician can risk opposing the system. Barry Goldwater tried, and it cost him. In 1976, candidate Ronald Reagan suggested investing Social Security's money in "the industrial might of America" instead of government bonds, and President Ford went on the attack. In 1980, candidate Reagan became a card-carrying defender of the existing program, just before the Florida primary.[44] He had learned his lesson. He won the primary.

[In the original manuscript of this chapter, I wrote that I did not expect President Reagan's bipartisan panel on Social Security reform to produce any statistically sound long-term proposal. I was correct. The panel presented its report on January 15, 1983. The President and House leader Thomas P. "Tip" O'Neill said they would support the panel's proposals. At best, the proposed changes will raise, net, $169 billion from 1984-1989, yet expenditures from Social Security are now over $200 billion a year. To accomplish this "heroic" feat, taxes on Social Security earnings will be imposed, but only on half the income from Social Security, and only on single people who receive over $20,000 a year, or married couples making $25,000. In other words, an *envy-based tax hike.* Predictably, it will not pull in very much money—perhaps $30 billion over the whole period—but "it's the thought that counts." Employees of non-profit organizations should start paying, the panel said. But, lo and

44. *New York Times* (March 4, 1980).

behold, not *present* Federal employees, meaning the panel members and their staffs. So employees of the Social Security system will still be safe. New Federal employees will be pulled in, and state and local employees who are now covered will not be allowed to pull out after 1983. There were some other minor changes. The bail-out cannot possibly work. It just means more taxes, following the tax "reform" of 1982 and the hike in Federal gasoline taxes in 1982. It is the same old game: spend and spend, elect and elect, tax and tax. The bills are coming due. No one has taught the politicians how to pay the political debts of earlier generations. There are still only two options: default openly and stop paying what had been promised, or default through mass inflation and price controls (to freeze the cost of living escalator).]

So you can run all the feature articles you like, with blaring headlines, "Social Security: Will It Be There When You Need It?" You can even admit the obvious: "Workers and congressional leaders agree that skyrocketing Social Security taxes must be rolled back. Now, the search is on for new ways to pay for pensions — or cut back on benefits."[45] But the search always leads to more taxes and increased, not reduced, benefits. You can write all the editorials you like. They do no good. You can even make stirring calls to politically liberal subscribers for courageous honesty and realism: "Why Not Be Honest About Social Security?"[46] No majority in Congress wants to be honest and realistic. Reform cannot be piecemeal; the whole program must be scrapped. But it won't be scrapped. The dollar will be scrapped instead.

Some people may think that I am cruel and devoid of compassion for criticizing the Social Security program. I am not heartless. I am not devoid of compassion. I am an economic realist. I can see what is coming. More than that: I predicted what has already come. Those most devoid of true compassion are those who will not face the politically inescapable realities of a bankrupt system of compulsory welfare, a giant chain letter which is bankrupting us — politically and economically.

I am not saying that we ought to abandon a wise, honest, morally and financially sound program. I am saying that the Social Security system is a giant, compulsory, immoral, uneconomical, bankrupt

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45. *U.S. News and World Report* (April 30, 1979).
46. *New York Times* (Dec. 21, 1979).

chain letter. The numbers simply aren't there. The system is certifiably bankrupt. I am not saying simply that we should abandon it; I am saying that we, meaning the voters, are going to abandon it, in the worst possible way we could abandon it, through the hidden default of price controls—repressed inflation. The chain letter is not only morally bankrupt; it is actuarially (statistically) bankrupt. I am saying that people who plan on retiring in the 1980s and live on Social Security's proceeds have made a horrendous mistake and must rethink the whole idea of retirement. I am not proposing that we abandon the elderly poor in this nation; I am proposing that we abandon the compulsory political chain letter that is stealing our funds—funds that should be used, in part, to help the elderly poor in this nation, and which need to be used to rebuild the nation's base of privately owned capital, which is the only way we can increase welfare and productivity. The elderly cannot eat paper money. Neither can the rest of us.

In short, I am not arguing that we should abandon a sound welfare and retirement program; I am arguing that we have never had a sound government program of long-term income security. The Social Security chain letter is about to bring in a "solution"—price controls—that could bring down the dollar, the free market, political freedom, and the whole economy.

It is not simply a question of the collapse of the chain letter. All chain letters eventually collapse. What concerns me is the possibility that *the collapse of this particular chain letter will probably bring down the world monetary system,* because the dollar is the linchpin of that world monetary system. Today, we face the possibility of the collapse of both: the chain letter and the world's monetary system.

On the other hand, we need to consider another possibility. The crisis of the international banking system—some $500 billion in bad loans of near-bankrupt nations—could bring down the monetary system. This, in turn, could speed up the collapse of the Social Security chain letter. I am not saying that this is a one-way street: the collapse could come from either direction, or from some other direction. Contrary to modern mythology, socialist economies are fragile; free market economies, because they are flexible, are more stable. It is the socialist economies around the world that can't pay their bills. Tiny, overpopulated Hong Kong, which has no natural resources, is doing fine economically; so is Singapore.

The politicians have run out of answers. They fiddle, tinker, have

conferences, publish reports. None of it accomplishes anything, except to eat up time. *The politicians are playing a waiting game.* They are, as always, just trying to get through the next election. They are so far gone that they think taxes on cigarettes and liquor will paste the system together for a little longer—additional regressive taxes on the working man.[47] Will we smoke and drink our way into solvency? This is madness. We are at the end of the line. Our political leaders have no solution. They are only trying to delay the inevitable. When they can no longer delay it, they will attempt to hide the reality of insolvency. You had better be ready then to take evasive action. You had better begin taking it now.

The Tax Burden

How big is the American taxpayers' liability? Nobody knows. The Treasury Department publishes a very, very conservative annual estimate of the total obligations of the Federal government. You can order it. It has the snappy title: *Statement of Liabilities and Other Financial Commitments of the United States Government.* It is published each year and delivered to Congress. It gets very little publicity. It isn't even typeset, just typewritten. As one congressman's legislative aide told me, "They spend as little money as possible on it. They put it out only because they are required by law to do so."[48] (You can order a copy from the Department of the Treasury, Fiscal Service, Bureau of Government Financial Operations, GAO Building, Room 3021, 441 G St., N. W., Washington, D. C. 20226.)

The 1982 report estimates that the liability of the Social Security system may be as high as $5.8 trillion (p. 24: "Note"). Though the report does not say so explicitly, this figure is based on the assumption of the Social Security Trustees that the United States will experience price inflation that will decline to no more than 4% per annum after 1995.[49] There are also liabilities for at least 39 other

47. "Conferees Favor Shifting of Taxes to Social Security: Plan on Budget Would Support Pension Fund With Levies on Liquor and Tobaccco," *New York Times* (May 24, 1982).

48. The late Senator from Massachusetts, Saltonstall, got this enacted in 1966: Section 402 of Public Law 89-809.

49. Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, *1982 Annual Report,* April 1, 1982; House Document 97-163 (Washington, D. C.: Government Printing Office, 1982), p. 32. The two more optimistic estimates assume that the consumer price index will rise at 2% and 3%, respectively, after 1995.

Federal pension programs: about $1.5 trillion. If prices climb at a rate higher than 4%, then the deficits will get much larger, since the pensions are indexed to price inflation. Please understand: no money has been set aside by Congress to pay these bills. They are *net unfunded liabilities*. They must be met by future taxes—your taxes—on top of the usual tax obligations for national defense, welfare, and the normal operating expenses of the Federal government.

The Social Security System is now spending about $200 billion per year on benefits to recipients, or about $2 trillion per decade. This figure will climb, as price inflation increases the benefit payments, and as the population ages over the next five decades. But even using a "minimum" figure of $2 trillion per decade, for 7.5 decades, we can forecast a spending burden of $15 trillion. Let's face it: a trillion dollars here, a trillion dollars there, and pretty soon it adds up to big money. It is easy to understand how the publicly admitted liability is almost $6 trillion, even with the government's unreasonably low estimate of 4% price inflation. Question: Where will the Federal government get the trillions needed to fund the program?

I am writing these words in early November, 1982. The 1982 congressional elections went against the conservatives in the House of Representatives, were inconclusive in the Senate, and went against them in the governorships. Incumbents, as usual, won most of their races. There is no sign of a major shift in favor of lower taxes and reduced Federal spending. The Social Security issue was avoided by Republicans when possible, but everyone who did speak out spoke in favor of leaving the program intact. There may soon be some sort of revision of the Social Security system, but it will not be a fundamental change. The President's commission on Social Security really did not come to grips with the problem. But whatever the solution, you can rest assured that it will turn out to be a stop-gap measure, more tinkering with a massive failure.

Rita Ricardo Campbell, an economist who has devoted many years to a study of Social Security, has given us a picture of what we can expect from the program. "Past federal administrations have hidden the festering financial imbalance behind an unbelievably intricate set of regulations and obfuscated the issues by using inappropriate terminology."[50] People have been told that they have paid

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50. Rita Ricardo Campbell, "Have You Really Paid for Your Benefits?" *Vital Speeches of the Day,* XLVIII (Nov. 1, 1981), p. 52.

for their benefits, but they haven't. Because Social Security benefits are indexed to price inflation, while private pensions are not, "No one receiving benefits today has paid for them in an actuarial sense."

The level of benefits has risen by 35% in "constant dollars" (meaning inflation-adjusted dollars), 1970-1980, while average weekly earnings in constant dollars dropped slightly. Life expectancy has risen, while fertility rates have continued to drop, to 1.8 children per woman. But the Trustees of the Social Security system continue to make their predictions on the assumption that the fertility rate will rise to at least the replacement rate of 2.1 children per woman.[51] "If nothing is done now to preserve the long-run financial integrity of the system, within a relatively short period of time a new, more serious insufficiency of funds will ensue."[52]

What can be done? First, make all of the 2.7 million Federal employees pay into the system. This would raise about $10 billion extra funds per year.[53] (Problem: What do you do when it comes time to pay them their pensions?) Second, index benefits to a lower measure of price inflation, such as the wage index. Third, reduce benefits for those who retire before age 65. Then raise the retirement age to 67. Does Dr. Campbell believe that these steps will bail out the system in the long run? No, she doesn't; they "will not ensure the long-run financial integrity of the social security system."[54] In short, the economists have run out of answers. The politicians always have an answer when the economists run out of answers: inflate!

I cannot resist citing an article by Paul Samuelson, the author of the most popular economics textbooks of the post-War period, the defender of Keynesian orthodoxy, MIT professor, and Nobel Prize-winning economist. It appeared in his popular *Newsweek* column (April 14, 1975). The title of the column: "Social Security: A-OK." He offered this bit of professional analysis:

> As the age of 40 nears, a thoroughgoing health checkup is in order. Our social-security system for old-age-retirement pensions, started in 1937 under FDR, has been going for 38 years. Fears have been expressed that it is becoming actuarially unsound; and, much worse, that at some time in the future, it will become bankrupt and be unable to pay the pensions so desperately needed and which people have earned the right to expect.

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51. *Ibid.*, p. 55.
52. *Ibid.*, p. 53.
53. *Ibid.*, p. 54.
54. *Ibid.*, p. 55.

> We have just had two independent audits. . . . The clinical findings are favorable. The patient is sound with a life expectancy that can be measured in the centuries. Both authorities agree.
>
> To be sure, there are some minor defects in need of attention, so to speak, like a mole that might become serious if not attended to. . . .

The mole was not attended to; it is now fatally malignant. It should have been obvious to the members of both distinguished panels of economists that the Social Security program was morally cancerous from day one, and therefore economically cancerous. But economists are slow to learn, and because they have spent two generations proclaiming the wonders of this cancer, they refuse to learn at all.

When it comes to forecasting the effects of compulsory wealth redistribution, you had better be more perceptive than the economists.

Conclusion

The Social Security chain letter is creating the seeds of a revolution. Young people, who are today the brainwashed products of a compulsory, messianic, and anti-free market public school system, and who are not generally noted for their future orientation or their willingness to accept personal responsibility for old people, will eventually discover that there is no one coming along behind them who will pick up the tab for them financially in their old age. But they have to fund the retirement years of those who have preceded them. They are now beginning to see the grim reality: Social Security's chain letter is too old, and there are too many names on the list, for the system to pay off for them. The game is nearly over. You know it, I know it, and they are beginning to figure it out, too. They will begin to ask themselves some questions. Why should they continue to support those old people who came before them, who "signed the list" decades ago? Why continue to "sign your name at the bottom of the list and then continue to send in up to $8,700 a year for 40 years"? The handwriting is on the wall. It is clear what is coming. They are going to "break the chain." They are going to find a way to escape their political, legal, and financial burdens.

Price controls are the quickest way to accomplish this, as we will see in the chapters that follow. Price controls are the product of ignorance, envy—the desire to "get even"—and cynicism. As the cynicism of younger voters grows, the American experiment in political freedom will receive its stiffest test in 50 years.

So will your investment portfolio.

The crisis can no longer be covered up. The public knows. Peter G. Peterson, who was the Secretary of Commerce in 1972-73, and who is the board chairman of the prestigious (and very influential) investment banking firm of Lehman Brothers Kuhn Loeb, blew a very loud whistle in the March, 1983 issue of *Reader's Digest:* "Can Social Security Be Saved?" His answer: not without major revisions — revisions so massive that the whole system will have to be scrapped and restructured. He admits that "By conventional political standards this program of reform may seem impossible." My view: it *is* impossible. Politicians, he says (as I say), "remain convinced that any party proposing serious reform will face annihilation at the polls. Inaction may therefore seem to constitute smart politics for a few more years."

Peterson pulls no punches. His article concludes with words almost as apocalyptic as mine (I am adding this reference to Peterson's article at the final proofreading of the page proofs of this book):

> But were the system to come crashing down, smart politics will be small consolation. Indeed, Social Security reform poses one of the deepest challenges to democratic politics in our history. It is a challenge above all to the middle- and upper-income citizens who largely determine the course of public policy and to whom the system dispenses a big share of its welfare, stealing capital from tomorrow's citizens — our children — and making cuts in government programs to the poor irresitible.
>
> The only alternative to reorganizing Social Security is to sit by while the system collapses, either through a revolt of young taxpaying workers against their elders or through a catastrophic flood of deficits. Maintaining the status quo is impossible, an utter fantasy which will visit upon our children the same conditions of economic chaos that attended the birth of Social Security.

Get ready for the crisis.

2

FIVE DEADLY ASSUMPTIONS

Some of the facts and opinions in this chapter will be familiar to some readers, but I suspect that there will be a lot of new information for everyone who reads it. I hope so, anyway. The economic issues that I treat here will be familiar in their basic outlines to most readers, but the implications for the long-run strength of the U.S. economy are not discussed very often. Ten years ago they were hardly discussed at all.

For those who haven't considered these facts, they may seem incredible. They just couldn't be true. All I can say to this kind of criticism is this: *think it through.* Check the facts out, and then make a decision. I am convinced that if present trends are not reversed—and politically, I don't think they can be reversed—then we are going to see massive bankruptcies. But these bankruptcies will not be declared openly. They will be concealed through a system of *repressed inflation*—the system of price and wage controls coupled with monetary expansion.

I am hitting at the very heart of men's hopes in these pages. I am not trying to scare people into action. I am doing my best to call people's attention to economic reality. Fear should not be our primary motivator in life. We should be willing to give fear its due, however. We should not take unnecessary chances. Any decision concerning the future which is not based on at least some of these facts is probably too risky.

It would be wonderful if a majority of Americans quit making any or all of the five economically disastrous assumptions that I deal with here. But they do make them, and they give little indication that they will cease making them in the near future. I would hope that none of my readers will continue to make any of them from now on. Forewarned is forearmed.

I. "My Pension Can Actually Be Paid Off"

If you are over 55, and if you don't live very long after your retire-

ment, then this may be an accurate assumption. I doubt it, however. Problems with the funding of private pensions will wipe out many dreams. So will the unwillingness of private pension funds' managers to keep bearing the risks of management. Thousands of small pension funds quit in 1975 and 1976, and the rate of drop-outs accelerated. The government is now making it harder for funds to drop out. This indicates the extent of the crisis.

The widespread use of pension funds in industry came during the Korean War. When the Federal government imposed price and wage controls, it left pensions out of the control system, so unions began making hard-nosed demands concerning pensions instead of wages. Corporations capitulated, sometimes knowingly, since they were aware of the vesting reality, namely, the likelihood (under the old laws) that the worker would never collect his money.[1] Not many people stay with the same company for 30 years. They quit, or get fired, or leave for one reason or another, and they lose their pension rights. Union leaders knew this, too, but they needed "victories," so they allowed the corporations to give in on the pension question rather than wage settlements. It looked good, and it didn't cost much: the days of reckoning were (then) in the distant future. That future is rapidly approaching.

Benefits are not rising fast enough to keep pace with price inflation. Pressures from unions and the government are now being placed on businessmen to be "socially responsible" concerning the looming pension crisis. Henry T. Blackstone of Goldman, Sachs & Co., has estimated that if pension fund assets are to keep up, by the year 2000, there will have to be literally trillions of dollars in assets. Where will pension fund managers invest the money? He concludes that "they're going to have to invest in government bonds and real estate to put that money to work."[2] Government bonds? But where will the government get the money to pay the interest to keep the pension funds alive? There are only three choices: taxes, borrowing, printing press money. The latter choice is always easiest for governments.

According to a 1979 report published by the Congressional Research Service (CRS) of the Library of Congress, in 1975 there were 500,000 private pension plans covering over 30 million people. It reports that a study contracted by the Labor Department found

1. "Vesting" means the ability of the beneficiary of the pension to take the accumulated assets with him if he is fired, laid off, or quits.

2. *Business Week* (June 16, 1975).

that completely retired people in the early 1970s realized an average increase in benefits of 2% per year, when price inflation was three to five times that rate. They were losing 4% to 8% of their real (purchasing power) income.[3] These losses increased later in the decade, according to another government study.[4] No wonder the report concluded: "Unless private pension benefits keep pace with increases in the cost of living, current inflation rates will drastically reduce the value of these benefits. Most private pensions do not now include automatic cost-of-living adjustments as do social security and Federal Government pensions."[5]

The CRS study offered a handy table for estimating inflation's effects on the purchasing power of pension benefits, which I have reprinted on the following page. At a sustained rate of price inflation of 15% for 20 years, today's $100 of income will have declined in purchasing power to $6.

Some critics think that employers should index pensions to price inflation. Great idea! But how? More investments in the stock market? But inflation wiped out the stock market, 1966-82; in terms of purchasing power, the market is down 70% from the February, 1966 high. Another suggestion: force pension fund managers to buy inflation-indexed Federal government bonds. This, I suspect, will eventually pass Congress and be signed into law. Problem: How will Uncle Sam pay off these indexed bonds without inflating the money supply, which raises prices, which forces up the price index, which compels the Federal government to raise more money to pay off the indexed bonds? Solution: freeze all prices and shut off the cost-of-living escalator (see Chapter 3).

As for state and local pensions, they are in shambles. There is no single source of information on such plans, since no Federal agency supervises their management. They (unlike private pensions) are allowed to operate on a "pay as you go" system, meaning present taxes are used to pay off all retired beneficiaries, just like Social Security. There are about 2,300 public employee retirement programs, covering about 9 million employees and retired people, with

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3. Carmen D. Solomon, *The Impact of Inflation on Private Pensions* (Washington, D.C.: Congressional Research Service, Library of Congress, 1979), Report No. 79-224 EPW, pp. 2-3.

4. Gayle B. Thompson, "Impact of Inflation on Private Pensions of Retirees, 1970-74: Findings from the Retirement History Study," *Social Security Bulletin* (November, 1978), p. 16.

5. "Abstract," Report No. 79-224 EPW.

PURCHASING POWER OF $100 OF FIXED PENSION BENEFITS UNDER VARIOUS RATES OF INFLATION

Years after retirement	Inflation Rate												
	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%
1	97	96	95	94	93	93	92	91	90	89	88	88	87
2	94	93	91	89	88	85	84	83	81	80	78	77	76
3	92	89	86	84	81	79	77	75	74	71	69	68	66
4	88	85	82	79	76	74	71	68	66	64	61	59	57
5	86	82	78	75	71	68	65	62	60	57	54	52	50
6	84	79	75	70	67	63	60	56	53	51	48	46	43
7	81	76	71	67	62	58	55	51	48	45	42	40	38
8	79	73	68	63	58	54	50	47	43	40	38	35	33
9	77	70	65	59	54	50	46	42	39	36	33	31	28
10	75	68	61	56	51	46	42	39	35	32	29	27	25
11	72	65	58	53	47	43	39	35	32	29	26	24	22
12	70	63	56	50	44	40	36	32	29	27	23	21	19
13	68	60	53	47	41	37	33	29	26	23	20	18	16
14	66	58	51	44	39	34	30	26	23	20	18	16	14
15	64	56	48	42	36	32	27	24	21	18	16	14	12
16	63	53	46	40	34	29	25	22	19	16	14	12	11
17	61	51	44	37	32	27	23	20	17	15	13	11	9
18	59	50	41	35	30	25	21	18	15	13	11	9	8
19	57	47	40	33	27	23	19	16	14	12	10	8	7
20	55	46	38	31	26	21	18	15	12	10	9	7	6

total assets (as of the mid-1970s) in the range of $90-95 billion. About 90% of this is invested in non-government securities, meaning stocks and bonds, and to a lesser extent, mortgages. This works out to about $10,000 of reserves for each potential and present beneficiary. But the major source of statistical data, the Social and Economic Statistics Administration of the Bureau of Census (Department of Commerce), records only present assets and present

payments of selected cities and states (*Finances of Employee-Retirement Systems of State and Local Governments*). These data do not include the really important figures, namely, the expected *future unfunded liabilities* of the various public pension programs.

A 1975 survey of 44 Pennsylvania cities revealed that over 75% of them had pension programs that were not adequately funded. Cities tend to borrow money from pension funds to meet operating expenses, as New York City did so spectacularly in 1976. It cost taxpayers in Pittsburgh $10 million in 1974 to meet pension liabilities. The total unfunded pension liability was over $225 million. The Los Angeles police and firemen's fund had assets of $400 million in 1975 and liabilities of $1.6 billion.[6] In 1975, the city of Oakland discovered that its police and firemen's retirement plan liabilities were accruing annually at a rate double the salary outlay, whereupon the benefits were lowered.[7] Pension fund debt literally threatens the future survival of state and local finances. If cities go under, who will pick up the pension tab? If the Federal government does, how will it get the funds to make the massive pay-outs?

If you have a pension, ultimately, you have become a long-term creditor in a period of price inflation. You have given up present dollars for future dollars that will be worth far less in terms of purchasing power. You have made a mistake. The old rule of Shakespeare is a good one: "neither a borrower nor a lender be"; but he forgot to add, "especially a lender in a time of price inflation."

The fact is this: *in a time of price inflation, no one but the very rich can afford to retire.* Your best pension program is a second job into which you can someday "retire." Forget your pension; start moonlighting. And start investing in assets that do not get eaten up by price inflation.

What about a Keogh plan for the self-employed, or an IRA account, or a corporate pension program in a small, closely-held corporation (for example, one set up on paper in the state of Delaware for about $100)? Doesn't this allow a person a tax advantage of being able to avoid income taxes on funds invested in the program? True enough, you can postpone income taxes until you retire and (presumably) drop into a lower income bracket. This assumes that inflation, the worst tax of all, does not erode the value of your pen-

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6. *Business Week* (Sept. 15, 1975).
7. *Business Week* (Sept. 13, 1976).

sion plan. It assumes that the government will not intervene "in order to help the small investor manage his retirement funds" and compel you to put the whole fund, or most of it, into government "retirement" bonds. This assumes that you can control the decisions concerning where your pension money will be invested. A Keogh plan or other retirement program that is administered by an insurance company or a bank trust department is going to be invested according to the "prudent investor rule," meaning it will be invested in those items that get wiped out by inflation: stocks, long-term bonds, mortgages. If you are not managing (strongly advising) your own fund, stay away from retirement programs. You are ultimately responsible for your retirement, not some trust fund employee. The prudent investor rule, as typically interpreted, is the most imprudent rule of all in a time of inflation and price controls.

As you can see, when it comes to Federal "tax breaks" for the "little guy," I am almost a total skeptic. However, I recommend the following strategy for anyone who wants to risk later confiscation by the government in order to set up a retirement program with pre-tax dollars (Keogh, IRA, etc.). If you are going to set up a retirement program, this is the only sensible way to do it. Here are my recommendations for a not highly recommended approach to retirement. Contact:

Lincoln Trust Co.
P. O. Box 5831, T.A.
Denver, CO 80217
(303) 771-1900

First State Bank of Oregon
1212 S.W. 6th
Portland, OR 97201
(503) 243-3525

[Note: 1982 revision of this manuscript. The 1982 tax "reform" package passed by President Reagan and a Republican-controlled Senate seriously weakened the tax breaks for one-man, "professional" corporations—something I had predicted for years. The handwriting is on the wall. The 1981 tax "reform" killed the earlier strategy I had recommended in this book: hard-money assets. These are no longer legal in new Keogh or IRA accounts. The only "hard-money" asset that can be bought without question is real estate. Because of tax reasons, this should be limited to land or zero-debt real estate. You want the tax breaks—depreciation and interest payments—for personal investing, not in tax shelters. But raw land cannot be depreciated, so it is still a reasonable part of a retirement program.]

My basic philosophy of investing in a retirement fund is to put the money in U.S. Treasury bills, through a T-bill money-market fund (e.g., Capital Preservation Fund) until you can begin to buy raw land. It will take a few years to build up enough assets to make the land purchases. You want the land in the path of predicted expansion, but far enough from the center of speculation so that you avoid paying too much initially. You want the appreciation to cover over several decades. Buy on the fringes, with each purchase farther out, as development moves toward your earlier purchases. By paying cash, you can demand a steep discount from the seller, who is normally able to sell only on a long-term note.

If you are unwilling to spend the time looking for land, then you should probably avoid a tax-deferred retirement program. The risks are too high. The government keeps changing the rules. But if you are determined to set one up, use a high-yield money-market fund as your major investment.

Another problem has only come to light since the spring of 1976, when Peter Drucker published his startling book, *The Unseen Revolution,* which deals with a phenomenon he calls "pension fund socialism." It seems that American pension fund managers have bought up about one-third of all shares of ownership of the 1,000 largest American corporations. Within 15 years, they will own a legally controlling interest in all American corporations listed on the New York Stock Exchange. There is tremendous significance in these facts for pensions. If the pension funds of the workers are invested heavily in American stocks, and the drift into corporate socialism (State capitalism, the corporate State, fascism, etc.) continues, then the equity of these pension funds will be destroyed. The productivity of the free enterprise system, on which all the pension hopes and dreams of American workers are based, cannot survive under socialism. It means either bankruptcy and the abolition of the pension obligations, or else it means the assumption of these liabilities by business' "partner," the Federal government.

Workers think they are going to beat the capitalist system. They think they can vote themselves benefits by expropriating the "capitalist exploiters" and the corporations. The trouble is, *they* are the owners. They are voting away their economic futures in the name of compassion, ethics, and kindness. They think they are doing it with other people's money. They aren't. When they find out, they will be outraged. Too late, of course. But stay out of their way.

II. "The Federal Government Guarantees the Future Value of My Bank Account"

This is what most investors want to believe. It is what the bureaucrats in the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC) probably want investors to believe. These are the Federal agencies that insure deposits up to $100,000. I suspect that this is what most citizens do believe. It isn't true.

The FDIC, like the FSLIC, is an independent agency of the Federal government. Congress does not appropriate funds to run it. It is supported by insurance payments made to it by the insured banks. But these premiums are low because the Treasury is understood to be the ultimate insurer of all deposits that come under FDIC supervision. In a major monetary crisis, the Treasury would have to bail out the FDIC. Everyone knows this.

The FDIC has practically no reserves. It is clearly not a true insurance program. Consider the following statistics. As of 1975, the FDIC insured 65% of all banking deposits in the U.S., 569 billion dollars' worth out of a total of $876 billion. To back up this massive quantity of deposits, the FDIC's fund stood at a paltry $6.7 billion. This means that of the officially insured deposits, the available fund would actually be about 1.2% of the actual deposits. But in a major financial crisis, the Federal government could hardly permit 35% of all bank deposits—the uninsured deposits—to be threatened with total contraction; the money supply would shrink, and the depression would be aggravated. Therefore, the FDIC really (politically) has been responsible for the whole structure of bank deposits during a major crisis. For this, the fund constituted .77%, that is, three-quarters of one percent.

By 1982, the statistics were not much better. The FDIC has about $12 billion to back up about a trillion dollars in deposits. The law now requires all banks to come under the "protection" of the FDIC. The combined deposits insured by both the FDIC and the FSLIC are around $1.5 trillion, with reserves around $17 billion. In short, the "reserves" are in the 1% range.

In March of 1982, Congress passed Resolution 290 (which is not legally binding) that assured depositors that Congress reaffirmed its commitment to support the banking insurance agencies. This was ironic, said critical Congressman Ron Paul, a member of the House

Banking Committee: Congress had never affirmed such a commitment, so it could hardly reaffirm anything of the kind. But the point is clear: politically, Congress is and always has been behind the various bank insurance agencies. Within weeks, the thrift industry had sponsored a national television commercial citing Congress' "reaffirmation" of its commitment to insure the thrift industry up to $100,000 per deposit.

The insurance fund is not much of a fund. Like the so-called "trust fund" of the Social Security system—assuming there is still anything in the Social Security trust fund by the time you are reading this—the FDIC fund is almost entirely composed of Federal debt certificates. In case of a bank emergency, the FDIC would have to cash in its bonds to get the cash to deliver to the banks. Where will the government get the cash? By printing it? Probably. By now the grim reality should be apparent: FDIC isn't much of an insurance scheme.

Why does it work? Because people *think* it can work. It *can* work, too, so long as there is no major panic. It can fulfill its obligations. But in a crisis, it would have to sell its U.S. debt certificates, and who would buy them if depositors believed that the banks were going bankrupt? What would people use for money if their checking accounts were being wiped out by the bankruptcy of the banking system? Obviously, there would be one major buyer: the Federal Reserve System. The FED would create the money to repurchase the bonds. In other words, all bank accounts will be paid off, in full, up to $100,000 per account—paid off in paper money.

This is the point. Yes, your bank account is insured. Yes, the FDIC is strong enough to back up your bank. But in a crisis, it can survive the test only by tapping the U.S. Treasury and the Federal Reserve System. It taps the one asset available to the Federal government during a crisis: fiat money.

This means that your bank account or accounts are insured, nominally insured. The dollars in your bank account are safe, if it is a Federally insured bank. In a major economic crisis, all accounts are effectively insured, meaning politically insured. But the *purchasing power* of those dollars is *not* insured. In other words, the future value of the present purchasing power of your bank accounts is not insured.

The problem goes even deeper than this. Because of the implied contractual obligation of the U.S. government to stand behind the independent agency known as the FDIC, the Treasury is an engine of inflation. The threat of depression, in other words, is reduced

primarily by the promise of monetary inflation. But if monetary inflation is the answer to contraction, then the value—in constant dollars—of your bank account is not only not guaranteed in the future, it is positively denied.

Once the Federal Reserve System begins to buy Federal government debt certificates in order to provide the funds necessary to give depositors their money, the process of fractional reserve banking takes over. The Treasury bills (bonds) in the FED's vault do not remain inactive. They serve as a reserve asset, and this asset then becomes the base for a new wave of credit—fiat credit—produced by the commercial banking system.[8]

There will be certain factors retarding this expansion. One of them might be the public's preference for holding cash, which shrinks the total money supply because it substitutes cash for fractionally reserved checking accounts.[9] This contracts the debt pyramid. The run on the banks from 1929-33 forced a shrinking of the U.S. money supply by about a third. Another factor which retards expansion is the unwillingness of businessmen to borrow money if they expect a depression. But once people understand that the Treasury has entered the markets to bail out the banking system, and people put money back into the banks and businessmen borrow in confidence, the fractional reserve process will accelerate, for the FED may be sitting on top of billions and billions of new Treasury debt, all ready and waiting for the commercial banking system to multiply at 2.5 to one or 3 to one for every dollar's worth of new debt in the FED's vault. The money supply will soar.

This will create a wave of monetary inflation to compensate for the previous threat of contraction. *Thus, the only answer that the Federal*

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8. See the book by Paul Meek, *Open Market Operations,* published by the Federal Reserve Bank of New York, 33 Liberty St., New York, NY 10045; available free of charge on request.

9. Fractional reserve banking is universal today. When you deposit a $100 bill in your bank, the banker sends about $10 to the regional Federal Reserve Bank, and then loans out $90. The recipient deposits the $90 in his bank, which sends $9 to the local Federal Reserve Bank, and then loans out $81. Up goes the money supply. Today, for every $1 in "high powered money"—government bonds—bought by the Federal Reserve Bank, something like $2.50 comes into circulation. This is the "money multiplier" effect. For details, see the books: *Modern Money Mechanics,* published by the Federal Reserve Bank of Chicago, P. O. Box 834, Chicago, IL 60690, and Paul Meek's *Open Market Operations.* The money multiplier is charted each week in *U.S. Financial Data,* published by the Federal Reserve Bank of St. Louis, P. O. Box 442, St. Louis, MO 63166; available free of charge on request.

government has for deflation and depression is monetary inflation. This leads to price inflation and ultimately to the breakdown of markets under price controls. Under these conditions, the present value of men's bank accounts is worth a lot more than the discounted value of their bank accounts' future purchasing power. The present interest rates are too low to compensate for this loss of future purchasing power. The public and the bankers have not caught on yet. They will, and there goes the future value of your bank account.

This is why I recommend that people convert the present value of their bank accounts to "hard goods," meaning consumer and producer goods, gold and silver coins, collector items, art objects, and even dehydrated food. Store that "present value" in something safer than paper money. Buy a home, equipment, durable goods, land outside the urban riot zones, or whatever. But don't hold on dearly to your paper money-denominated bank account simply because the account is insured by an agency of the Federal government. The *number* of dollars is undoubtedly insured; this fact almost insures that the future purchasing power of those dollars is not insured.

III. "A Depression Is Impossible Today"

Back in 1931, the Viking Book Company published a delightful, humorous little book, *Oh Yeah?* It was filled with quotations from the late 1920s by famous economists, political leaders, industrialists, and investing "experts" who assured everyone that prosperity was here to stay. It wasn't. Page after page of optimism, yet for all the optimism, one quarter of the work force in the United States was unemployed in 1933. It didn't matter how many Ph.D.'s had said that depression was impossible in 1929. It came anyway. Irving Fisher, Yale's prestigious economist, had predicted continued prosperity in early September, 1929; three years later, he had lost his whole fortune which had been in the millions. It sounded great in mid-1929; it was a joke by 1931.

When I first published this book in 1977, there was just as much optimism among economists, political leaders, and industrialists as there was in 1929. There can't be another depression, we were reassured; the Federal government has the means available to prevent one. All the top experts at all the top universities were agreed: the economic policies of John Maynard Keynes (pronounced "Canes") and his followers will prevent any future depression. These men assured us that they knew how to use Federal power and

Federal coercion to redistribute other people's money—your money—to benefit the unemployed poor. These poor people, as well as the Federal bureaucrats, will spend us into prosperity if a depression should begin. *Spend ourselves rich:* this was the promised new magic of Keynesian planning. This means that people on the dole will use your money to spend themselves rich, and if all goes well, you may be allowed to go along for the ride.

By 1981, this optimism began to fade. Senior economists were admitting that there was a "one in ten" chance of a depression. Such numerical estimates meant nothing; economists were saying merely that there was some likelihood of a depression, in their view. Lawrence R. Klein, the Nobel Prize winner in economic science, and one of the early developers of "scientific economic forecasting" and "macroeconomic model building," reported in late 1982 that a depression is possible. He did not think it will happen, but it is possible. He asked: "But could the unthinkable happen? Yes, if other large debtors find themselves in a situation like Mexico's, if widespread protectionism develops through the erection of tariff barriers, if many private industrial corporations fail, if there are widespread depositor runs on banks, if the Federal Reserve Board and other monetary authorities fail or refuse to accommodate the requests for liquidity. If there are significant supply interruptions (as in the case of oil), then we could have economic depression with chaos in financial markets. This is the ultimate unthinkable."[10]

Notice a key phrase: "if the Federal Reserve Board and other monetary authorities fail or refuse to accommodate requests for liquidity." That means "if they refuse to inflate the money supply." This is always the ultimate solution to recessions and depressions. It is the reason why the public no longer trusts the wizardry of the monetary experts.

The government never *spends* a dollar unless it has first *confiscated* a dollar from a productive member of the society. It can get funds from only three sources: (1) direct taxation (meaning from the wallets of the middle classes); (2) borrowing (meaning that the interest payments must be paid for from taxes collected from the middle classes); and (3) the creation of money. In the third case, the government spends the money into circulation, yet nobody else has reduced his spending (by paying taxes or by loaning the government

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10. *Los Angeles Times* (Sept. 28, 1982).

money). Therefore, prices will tend to rise as goods and services are chased by the new dollars and the old dollars. There is no new production. There is no new wealth.

The experts tell us that the new Federal spending will encourage businessmen to invest more money and create new output and new jobs. This may be true, but someone has to pay for these investments. Who pays? Those on fixed incomes who cannot spend more money when prices rise in response to the newly created inflationary dollars. It is a form of forced saving. Furthermore, the old boom-bust cycle begins once again. Businessmen invest because they think that rising demand for their goods will continue. But this requires ever-increasing quantities of unexpected and unforecasted new money; once begun, the Federal government cannot "kick the habit" of inflated money. There may be a renewed economic boom, but only because a new boom has been created by the inflated dollars. A new wave of price inflation begins. The only way to stop this new wave of price inflation is to stop the creation of new, fiat money. This, of course, brings back the depression.

What do we mean by depression? Usually, we mean those features of economic life that appeared in the 1930s. These included the following: falling production of goods and services, falling prices and even more rapidly falling wages, unemployed resources including unemployed people, businessmen unwilling to borrow money for capital expansion, and pessimism. Another sign of depression is a falling stock market. Naturally, bankruptcies are common, as people fail to meet their debt obligations. When all of these features are visible in an economy, we say that it's experiencing a depression.

The problem with this analysis is that some of these conditions are also present during periods of repressed inflation (price controls): reduced output of goods and services, bankruptcies, unemployment in some areas of the economy, and pessimism. What we do not see is a rising price level (illegal markets excluded, of course). We see unemployed people and unemployed resources, such as in Germany in 1946. Fewer and fewer people want money, however, simply because *in a totally controlled market, money won't buy anything.* About all it is good for is *paying taxes* and *paying off debt.* In a partially controlled market in which price controls are not enforced vigorously, borrowed funds can be used for black market purchases, and people are willing to borrow. But the really bad features of a depression are present in a

truly repressed inflation—the price control economy. One big difference, however, in a controlled economy, is that those who know how to buy and sell in the alternative (black) markets can prosper. In a depression, it takes very different skills to prosper. Barter, however, can be found in both systems. During a depression, people often don't have enough money to buy goods; in a repressed inflation, people are not willing to accept money in exchange for goods.

By inflating the money supply, the Federal government can temporarily postpone a depression. Once the fiat money has lured businessmen, investors, and savers into making poor economic decisions concerning the future condition of the economy, the nation's capital structure becomes radically distorted. *The depression is simply the market's response to this government-induced distortion, or better, series of distortions.* The government can postpone the readjustment of the economy for a time, even decades, but only at the expense of more distortions, more fiat money, and more wiped-out pensions, annuities, and other long-term credit instruments. Then, when the government finally stops producing fiat money, the banking system collapses, the money supply shrinks, prices fall, and unemployment skyrockets.

There is one way, and only one way, to avoid the traditional deflationary depression at the end of mass inflation. That way is the ration-card economy. *Price controls can create an economy so prostrate, so broken, so unproductive that the traditional depression never occurs.* On June 18, 1948, according to conventional historical sources, the British, French and American military occupation governments issued the currency reform law recommended by Dr. Ludwig Erhard, who was then the Economic Director of the British and U.S. zones of occupation, and who later became the finance minister of Germany. I have an English-language transcript of Erhard's account of the event. He claims that he acted independently, and that Gen. Lucius Clay backed him after his famous radio broadcast. Erhard went on the radio on Sunday, June 20, and announced that all bank accounts would be reduced by a complex formula, the reduced money supply would then be stabilized at the new level, and all price controls would be removed—the next day! On Monday morning, millions of unemployed workers voluntarily went back to work.[11] They could at last get a competitive wage for their labors, denominated in a currency unit

11. Jacques Rueff, *The Age of Inflation* (Chicago: Regnery Gateway, 1964), ch. 4.

with a future. The German economy began its 30-year economic miracle.[12]

This policy of freeing up the economy, of making men responsible for their own actions, was incredibly successful. Thus, the deflation of the money supply did not bring with it the traditional deflationary depression. Why not? Because Germany's economy was in such shambles that there was nowhere to go but up, once personal freedom to make voluntary contracts was restored. In short, repressed inflation had been so devastating that Germany avoided a traditional depression. Repressed inflation was far worse.

Sadly, our own government will probably be forced to take this repression road as the alternative to a traditional depression such as we experienced in the 1930s. *To avoid something terrible, the politicians are going to impose something far worse.* If they leave the controls on long enough, if they see to it that serious attempts are made to enforce the controls, if they ration goods and services, if they continue to inflate the money supply, and if they do not allow the market to operate, yes, we may escape a so-called depression. We may find our economic system in such chaos that the ultimate deflation (or conversion to a totally new currency and credit system) will not produce a deflationary depression.

Does this comfort you?

IV. "My Guaranteed Annuity is Safe"

What is an annuity? Basically, it is a contract between an individual and an institution. The individual turns over to the institution a fixed amount of money, and the institution guarantees to repay the individual a fixed quantity of money, month by month, over the remainder of his lifetime. Very often, the individual pays a nominal sum over the first 20 years of his working days, or perhaps a lump sum when he is about 40 years of age, and the institution agrees to begin paying him his monthly checks when he turns 65. The interest on his money is used by the institution to build up sufficient equity to allow the steady repayment of its obligation at the specified time. Obviously, the earlier a person turns over his money,

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12. F.A. Lutz, "The German Currency Reform and the Revival of the German Economy," *Economica* (1949), pp. 122-42; Fred H. Klopstock, "Monetary Reform in Western Germany," *The Journal of Political Economy,* LVII (August, 1949), pp. 277-99; Horst Mendershausen, "Prices, Money and Distribution of Goods in Postwar Germany," *The American Economic Review* (1949), pp. 646-72.

the longer the interest can accumulate, and the smaller the lump sum has to be to assure a stated monthly income after age 65. Those who live long lives, of course, can benefit greatly. People whose parents died at age 55 would be wise not to purchase an annuity, however, if their parents died from natural causes.

What is the *weak link* in the annuity contract? Everyone should see it instantly, yet few people do. *The contract is denominated in paper money.* In the twentieth century, except in Switzerland, all annuities have been unsound economic bargains for the vast majority of individuals who have purchased them, and an excellent investment for institutions selling them. Back in the 1930s, companies that sold annuity contracts would feature advertisements of smiling elderly couples, sailing on lovely ships, with the caption: "We retired happily on $200 a month." Indeed, they did; a person investing in an annuity in the United States in 1921 probably made a smart decision, assuming the company or institution didn't go bankrupt in the 1930s. But those making annuity contracts since then have watched those ads change over the years: $300 a month, $400 a month, $500 a month, and these days, the monthly income is left unstated. Why advertise failure? I have not seen one of these "We Retired" ads for over a decade.

Inflation does not create wealth. It destroys wealth by redistributing wealth and creating an unwillingness of people to invest in money-denominated, long-range capital projects. Eventually, though very late in the "game," most people catch on. But for millions of unsuspecting families, the information comes too late. The modern annuity looks good to investors, especially those who were emotionally scarred by the Great Depression and still think of economic crisis in terms of falling income, falling prices, and unemployment. They remember how tough it was back in the 1930s. They remember how well people did who had guaranteed paper money incomes during an era of falling prices. They never forget the losses of their youth, almost like generals who never forget the strategies of the last war. They prepare for a deflationary crisis that will not come, or at least will be preceded by another kind of crisis that wipes out the strategies aimed at solving the crisis of the 1930s. They buy an annuity.

When a person asks the question, "Will my annuity be safe?" he really means something very different: "Will my real income be safe?" The salesman of an annuity can point to long years of fulfilled

contracts—money-denominated contracts—and boast with pride of the certainty of payment. Too few Americans think through the implications of price inflation for long-run contracts. *They forget that their joy in getting a mortgage which they will be able to pay off with "depreciated dollars" will be matched by their sorrow in having their annuities paid off in those same depreciated dollars.* Yet people are optimists in America, and they want to look at the positive side. Skinning their creditors with fiat money is the bright side of long-term contracts; being skinned by their debtors is forgotten. For some reason which I cannot explain, people refuse to understand that huge corporations like insurance companies are *debtors* to those who buy annuities from them, and that middle-class individuals are, economically speaking, creditors to these huge firms. "How could I be a creditor to Prudential? After all, I'm just a little guy, and it's huge." So they become long-term creditors, just like the savings and loan company that loaned them the money to build their homes. *To be a long-term creditor in times of inflation is economically suicidal.*

There is one possible way around this problem, the one recommended for many years by the conservative American Institute for Economic Research.[13] Buy a Swiss annuity payable in Swiss francs. Those who took their advice in the 1950s and 1960s, and who are now receiving their monthly checks, have seen their investment appreciate by about 40%. The Swiss franc has remained stable in purchasing power, while the U.S. dollar has dropped in relation to the Swiss franc. But how many people will call a Swiss bank's branch in New York, and ask about the possibility of buying a Swiss annuity through a Swiss firm using the bank as an intermediary? Only the very wise, very informed, and very suspicious (unpatriotic, so-called) investors who do not want to be skinned alive by inflation during their retirement years. Who knows the name of the major Swiss banks, like Union Bank of Switzerland, Swiss Credit Bank, or Swiss Bank Corporation? Not the average buyer of an annuity, certainly. (If you are interested in purchasing a Swiss annuity, you might want to contact Assurex, S.A., Obstgartenstrasse 7, 8006 Zurich, Switzerland.)

In the final analysis, no one can guarantee the value of an annuity. At best, you can have the dollar income guaranteed, but in a time of

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13. Their headquarters are in Great Barrington, Massachusetts. They publish a number of excellent books on annuities, life insurance, gold, etc. I especially recommend their book, *Annuities From the Buyer's Point of View* ($2).

inflation, this guarantee is not very meaningful. In a time of deflationary depression, meaning falling prices, or in a time of stable money, higher production, and falling prices, the annuity is a good deal. But companies tend to go bankrupt during depressions, leaving the owner of the annuity out in the cold. If you expect inflation, stay away from annuities. If you already own one, you had better not rely on it to provide you with security in your retirement years.

V. "The Government Will Control Inflation"

This is the heart of the problem. The government, meaning the Federal government, *can* control inflation. By this, I mean that the government can control the supply of money coming into use in the economy. It can regulate the banks to prohibit new deposits (checking accounts) that serve as money, prohibit the central bank (Federal Reserve System) from buying Federal debt to be used as reserves for new money, demonetize gold or permanently freeze its official price, and refuse to create money directly by printing it. That will stop the process of monetary inflation. By stopping the process of monetary expansion, the Federal government can undoubtedly put a stop to price inflation. But as investors ought to have learned by now, *this decision to stabilize the money supply will lead to a severe recession and finally a depression.* Politically, no existing political party can afford to take such a necessary and drastic step.

The best the government can do, politically though not economically, is to *control official prices.* This really ruins those who are afraid or otherwise hesitant to participate in the unofficial (black) markets. But the government can achieve an absolutely crucial political goal, without getting blamed (for a while) for the painful and often disastrous consequences associated with the achievement of this goal. *The goal is simply the reduction and outright abolition of government indebtedness. The government pays off with worthless money.* This is something the government can and almost certainly will do. If this is what you mean when you say, "The government can control and will control inflation," then I guess you're right. Congratulations; we lose again.

Controlling official prices means *controlling the voluntary transactions of individuals* who want to trade at prices above the officially decreed maximum. This is the heart of the meaning of price controls. The result, inevitably, is to reduce productivity. It is free men who produce most effectively. The price controls system is almost the worst thing that can happen to a free economy. It is not so bad, perhaps, as

outright confiscation by government officials, but it is close.

Conclusion

The free market is like a giant auction. In fact, it *is* a giant auction. What the government says is that the auction is not allowed to go as high as some of the participants are willing to take it. It is as if the bureaucrats came to every auction in the country and product by product, sale by sale, stepped in and decreed a maximum price on the bidders. Worse, the price controllers do it when they know that the maximum market (voluntary) bids will be above their officially permitted prices. So what happens when half a dozen bidders in a bidding battle hit a maximum price, and the auctioneer says, "That's it gentlemen; no more bids"? What happens in an economy as complex as ours when the bureaucrats announce to 200 million bidders, "That's it, Americans; no further bids"?

Everyone knows that the auctioneer (seller) tries to get the highest possible price for his goods. We know that he can get no higher price than the final buyer is willing to pay. We don't pass laws—officially, anyway—that single out auctioneers as Price Gougers or Exploiters of the People. Yet we single out sellers (producers) as monopolists and exploiters for raising their prices to a level that other buyers are willing and able to pay. *Buyers set prices.* Or more specifically, the *final buyers* who are still willing and able to make the purchase set prices when they buy from the seller who is offering the lowest bid available. Prices climb because there are effective bidders left in the Great American Auction (or even the Great World Auction).

This auction has made us the richest people in the world. It has led to the incomparable growth of the American economy. The Great American Auction has enabled the poor people of this nation to live better than kings of the middle ages, better than most of the people on earth. And now we face the prospect of a controlled auction. Nevertheless, the basic problem still remains: *How are the scarce economic resources going to be allocated if the price controllers set maximum prices on the legal bids?*

This book is an attempt to answer this question. The man who finds the answer first has an enormous advantage over the other potential bidders in the Great American Auction (controlled). He has recognized the fundamental truth of price controls: *price controls are people controls.* He takes steps to avoid becoming one of those who are controlled.

3

SHUTTING OFF THE COST OF LIVING ESCALATORS

If educated people can't or won't see that fixing a price below the market level inevitably creates a "shortage" (and one above it a "surplus") it is hard to believe the usefulness of telling them anything whatever, in this field.

Frank H. Knight[1]

By a ratio of 5 to 4, the public favors the return of wage and price controls as a way of fighting inflation, a Gallup Poll survey shows.

Los Angeles Times *(Aug. 19, 1974)*

Again and again I'm asked why I think that the Federal government is going to reimpose price and wage controls. "Haven't they learned that controls don't work?" A variation on this question is, "Hasn't the American public learned that controls don't work?" These questions betray a fundamental lack of knowledge about the learning process of men who live in an era totally skeptical of permanent principles, especially economic principles. Every President is praised—Nixon excepted—for surrounding himself with "pragmatic" advisors who will not seek to impose any ideology on the public. Nixon alone is supposed to have been lax in not surrounding himself with "moral" men, i.e., economic and political liberals who are smart enough not to get caught. The press once whooped it up for Jimmy Carter's advisors by using the same old pitch: Carter was not an ideological Southerner or an ideological Christian, just as Jack Kennedy was not an ideological Roman Catholic. All was supposedly well. In fact, the main worry among the "pragmatic" mem-

1. Knight, "Truth and Relevance at Bay," *The American Economic Review,* XXXIX (Dec., 1949), p. 1274.

bers of the press was that he kept asking us to "trust me," and no one in his right mind ever trusts a pragmatist. The pragmatism of modern liberals is viciously ideological. It tells us that principled action over the long run cannot "work." It tells us that we must try anything and everything in crisis situations. It tells us that basic economic laws do not and cannot exist, for that would imply a fundamental stability of nature, including human nature. Everything is up for grabs in the pragmatist's universe. And everyone is grabbing.

In the Midwestern summer school sponsored by the Intercollegiate Studies Institute back in 1972, Russell Kirk was brought in to give a speech about American conservatism. He began his lecture by relating a discussion he had with President Nixon. "Dr. Kirk," Nixon told him, "the American people are not interested in a President who serves as some kind of moral leader." Indeed they weren't, and they got just exactly what they wanted. Now they want the trappings of moral leadership, but with sufficient pragmatism attached (say, about 95%) to insure that the economic cornucopia doesn't run dry. That's what men believe today: pragmatic economic policies can and must produce a world of abundance.

This leads me to the topic at hand. In late July and early August of 1971, Nixon and his top economic advisors discussed the possibility of imposing price and wage controls. Nixon wanted them. William F. Buckley sensed this, and even published a column on the topic, "Will Price Controls Be Next?" on July 29.[2] The chairman of Nixon's Council of Economic Advisors, Paul McCracken, was against them—so against them that he wrote an essay rebutting John Kenneth Galbraith's call for controls. It was published in the July 28 *Washington Post,* and was reprinted in the First National City Bank's (later renamed Citibank) *Monthly Economic Letter* for August. The issue was delivered all over the country during the week of August 15—after the controls had been imposed—and McCracken then went out for the next few months to barnstorm *for* the controls. He announced his resignation from his post as chairman of the Council of Economic Advisors three months later, in late November, 1971. Too late. Also, too quietly.[3] Instead of resigning in protest, he

2. William F. Buckley, *Inveighing We Will Go* (New York: G. P. Putnam's Sons, 1972), pp. 312ff.

3. United States Steel got McCracken to front a two-page advertisement against controls in 1976: *Reader's Digest* (July, 1976).

stayed on until the end of the year. He told one reporter that he did not want to leave until Phase Two of the controls was satisfactorily underway.[4] (Oddly enough, I had discussed the possibility of joining the Nixon economic staff in some [probably minor] capacity in a couple of letters in 1970 with Nixon's appointments secretary, Dwight Chapin, whom I had known in high school. I told Chapin that I would have to resign in protest if the President ever imposed controls, which in early 1970 I was concerned about. I never received another letter from him. Chapin, a very decent guy as far as I've ever known, later served a jail sentence for being involved in Bob Segretti's "dirty tricks" program, and is today the editor of *Success Unlimited* magazine.)

Prof. Sam Peltzman, who was then serving in a research spot in the Council's staff, told me later that not a single man on the Council of Economic Advisors favored controls. They had actively warned Nixon against imposing them.[5] Most of them were good economic empiricists, especially University of Chicago empiricists (free market pragmatists with graphs), and they all knew that controls "don't work"; this included Herbert Stein, who subsequently wound up as the designer of "Phase Two" of Nixon's controls program and then replaced McCracken as Chairman.[6] But Arthur Burns, chairman of the Federal Reserve System, wanted controls, and Nixon felt that he had to Do Something. So he did.[7]

He was greeted with huzzahs from every political group except big labor, i.e., unions. The National Association of Manufacturers cheered, the national Chamber of Commerce cheered, and when surveyed, 75% of randomly selected citizens cheered. The July, 1972 issue of *Nation's Business* reported that the overwhelming majority of top-level American businessmen supported Nixon. The only argument concerned the length of time Nixon should leave on the controls: forever vs. a few years. Even the supposedly "Chicago

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4. *The Commercial & Financial Chronicle* (Nov. 25, 1971).

5. Peltzman had left the Council the Friday before Nixon's Sunday announcement of the controls.

6. Reported *The Commercial & Financial Chronicle* (Nov. 25, 1971), "The fact that Herbert Stein of the Council will succeed McCracken denotes the President's 100 percent support for the Phase Two program."

7. A very good background article on Nixon's decision is Juan Cameron's "How the U.S. Got on the Road to a Controlled Economy," *Fortune* (Jan., 1972).

School"-oriented *Review* of the St. Louis Federal Reserve Bank ran an essay that concluded:

> 1. An effective system of wage and price controls can reduce inflationary pressures faster than with traditional stabilization policies if it succeeds in eliminating expectations of inflation sooner than otherwise.
> 2. A moderate rate of monetary expansion is essential to the maintenance of a rate of increase in aggregate demand consistent with the dampening of fundamental inflationary pressures.[8]

The result was predictable, but the proponents of price controls refused to predict it or even admit it: the shortage economy.

What does all this prove? Simple: when it comes to economic pragmatism, the conservative (anti-controls) pragmatists do not carry the field against the political (Do Something) pragmatists. Sooner or later, the politicians in office and the court economists who advise them take the position of a 1978 Herblock political cartoon: a couple in a car, caught in a driving rain, with lightning coming out of a dark cloud labeled "inflation." Close by is a falling-down old house labeled, "Wage-Price Controls Motel . . . Vacancy." The caption says it all: "It may have a lousy rating, but it's looking better all the time."[9] Sooner or later, a "conservative" economist like Paul Einzig feels compelled to write something like the following statement in some business-oriented journal or newspaper: "At long last British Prime Minister Edward Heath's government took its courage in both hands and resorted to a statutory wage and price freeze. It ought to have done this two years earlier, having gone to the country, with a laissez-faire programme, it felt bound by it, even though it had departed from laissez-faire in several other respects."[10]

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8. R. Alton Gilbert, "Monetary Policy and Relative Prices in an Incomes Policy," *Review* (Nov., 1971), p. 7.

9. *Washington Post* (Aug. 24, 1978).

10. Einzig, in *The Commercial & Financial Chronicle* (Nov. 16, 1972). This now-defunct but ancient business newspaper had been filled with articles favoring the imposition of controls for many months prior to Nixon's decision. Walter Heller's front-page essay, "Our Economic Environment as We Enter the Seventies," which favored wage-price guidelines (Dec. 18, 1969); Robert H. Wessel, "The Case for Graduated Direct Controls" (July 10, 1969); Arthur Burns, "Broad Incomes Policy to End Cost-Push Inflation" (Dec. 10, 1970); James J. O'Leary, "Can Full Employment and Price Stability Be Achieved?" (Dec. 31, 1970); "Banker Urges Total Freeze on All Incomes" (Feb. 18, 1971); E. Sherman Adams, "How A National Incomes Policy Can Stop Price Inflation" (March 19, 1970); Paul Einzig, "A Proposal for Devaluation Without Price Inflation" (July 15, 1971); and, most

Pragmatists, meaning political pragmatists, do not learn from history, including economic history, because they do not believe in history. They do not believe that there are lessons to be found in history, they say, because "each era creates its own (tentative) rules." Look at American foreign policy. Intellectuals were generally isolationists at the turn of the century, but their support of domestic economic intervention (Progressivism) led them into the arms of Woodrow Wilson and "Col." E. M. House. After the debacle of World War I, they returned to isolationism, especially after 1925. By 1939 they were being dragged by Roosevelt back into internationalism. The "Munich Syndrome"—a fear of disengagement—dominated American foreign policy until Vietnam's losses began to affect voting behavior. Now American intellectuals are divided; they don't know whether to speak softly and carry a big stick, speak loudly and carry a big stick, or speak loudly and sell the big stick to the U.S.S.R. (on long-term, below-market loans) or the Arabs, or give the big stick to Israel (at least when the Labor Party is in office). History teaches them nothing because pragmatism is at bottom a philosophy which proclaims the rule of chaos—the abandonment of principles that might be used to sort out the facts of history and create meaningful, instructive patterns. They laugh at Henry Ford's dictum, "history is bunk," but they believe it.

The one business writer who remained absolutely opposed to controls, from start to finish, was *Barron's* editor, Robert Bleiberg. He wrote against them in 1970.[11] He wrote against them after they were over.[12] There were not enough principled, literate men in high positions like him in the 1970s. There never are.

There were also a handful of economists who forthrightly denounced the controls from the beginning. They were not famous economists in prestige universities. They were people like Murray Rothbard, who wrote a classic critique of the whole program almost

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significantly, Arthur Burns' front-page announcement, "Only Direct Government Intervention in Wages and Prices Will Halt Inflation" (August 5, 1971). The *C&FC* did allow other voices to be heard, however, including my early essay, "Wage-Price Controls: Effects and Counter-Effects" (Aug. 21, 1969); Raymond J. Saulnier, "Orthodox Policies Will Put Economy on a Sound Basis" (Dec. 10, 1970); and W. Allen Wallis, "Tight Money, Not Controls, Needed to Combat Inflation" (Jan. 6, 1972).

11. "Counsel of Despair: Wage-Price Guidelines Should Stay in Well-Deserved Limbo," *Barron's* (May 25, 1970).

12. "Farewell to Wage and Price Controls," *Imprimis* (July, 1974); "Return to Controls?" *The Alternative: An American Spectator* (Feb., 1975).

before the ink was dry on Nixon's orders.[13] He began his essay with a relevant question: Who opposed the action?

> On August 15, 1971, economic freedom died in America, and the terrible thing is that everybody cheered. Where was the opposition? Where are the people who, for four decades now, have been denouncing wage and price controls?
>
> Where are the businessmen? For decades the business community has been proclaiming its devotion to free enterprise, to the free price system. For decades, they have been attacking direct controls on prices and wages. Where are they now? They are the loudest and most delighted of the cheering squad. . . .
>
> Where are the conservatives now? For the most part, we have heard only a resounding silence. In fact, many conservatives have simply joined in the cheering, have hailed the dramatic move by our "strong" President, and have curiously forgotten their supposed devotion to "strict" construction of the Constitution as a protection for our liberties. . . .
>
> And where are the nation's economists? For at least two decades, virtually all of the nation's economists, let alone Arthur Burns, Paul McCracken and the other Administration economists who have led us to the destruction of the free economy, have told us, with all the certainty of which they are capable, that price controls do not work, that they tackle only the symptoms and not the causes of inflation, that controls do not halt inflation but only bring about shortages, distortions, disruptions, and black markets. Yet virtually all of them have jumped on the control bandwagon, with no hesitation whatever. . . . How ironic that the only large-scale and determined attack on the wage-price freeze was launched by the very Democrats and labor unions that had been calling for controls for many months! Some of the union rhetoric was impassioned and even denounced the controls as dictatorial and unconstitutional—thus reminiscent of the conservatives and businessmen of days gone by.

It was *The Libertarian Forum* (June 15, 1970) which had predicted that controls might be imposed, since the ultimate solution to price inflation—the cessation of monetary inflation—was too strong a medicine for Arthur Burns. Rothbard went on for eight fine-print pages in analyzing why the controls would bring disruptions and shortages. But economists and politicians were unaware of a tiny circulation newsletter like *The Libertarian Forum.* It was simply too ideological to be taken seriously.

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13. Murray Rothbard, "The End of Economic Freedom," *The Libertarian Forum,* III (Sept., 1971).

Other "Austrian School" economists denounced the controls. Hans Sennholz and Henry Hazlitt both published articles against the controls in the tabloid newspaper, *Christian Economics* (Feb., 1972). But no economists or politicians ever read *Christian Economics.* It was simply too religious and ideological to be taken seriously.

And men in high places will not take this book seriously. It, too, is too ideological to be taken seriously by the policy-makers of our era. It is an affront to the religion of pragmatism. This is why you had beter begin to hedge against the economic disasters it describes, just as wise investors prepared when they recognized what Nixon did in 1971.

The Astronomical Federal Debt

One of the most worthy organizations deserving of your financial support is the National Taxpayers Union (NTU), 325 Pennsylvania Avenue, S.E., Washington, D.C. 20003. The NTU publishes a monthly newsletter, *Dollars and Sense* ($15), and they used to provide Sen. Proxmire with most of his ammunition, e.g., congressional junkets, obscure research projects, etc. The NTU digs up important facts that the public would otherwise ignore—crucially important facts. They rummage through obscure Treasury Department reports and find out what the real level of Federal indebtedness is.

The United States government operates on a "cash" basis of accounting. Normally, even moderately large businesses use the accrual system, i.e., future income and future outlays. John N. Myer, in his useful little paperback book, *Understanding Financial Statements* (New American Library, $1.50), writes: "The cash basis is so simple as hardly to require any knowledge of accounting. . . . As will be shown, this method of measuring income does not produce a useful estimate of performance and, therefore, its use is more or less limited to small retail business where the owner is in such close contact with all phases of the operation that he does not require a better measure of performance." Or, he might have added, in cases of multitrillion dollar economies in which no one in government wants to let the voters know what is going on "in all phases of the operation."

The National Taxpayers Union monitors a very important government publication, the universally ignored *Statement of Liabilities and Other Financial Commitments of the United States Government* (Sept. 30, 1981; released Jan. 1982). Each year, the NTU sends out a unique promotional flyer based on this annual government report. It says

on the outside of the envelope, "Your statement is enclosed." It looks like a bill. It *is* a bill—your bill from the Federal government. On the first page of the letter, we read: "Your attention is directed to the amounts due as indicated below." Your 1982 bill:

Debt or Liability Item	*Gross Cost*	*Your Share*
Public Debt	$ 1,050 trillion	$ 13,125
Accounts Payable	167 billion	2,088
Undelivered Orders	487 billion	6,088
Long Term Contracts	21 billion	263
Loan & Credit Guarantees	360 billion	4,500
Insurance Commitments	2,227 trillion	27,838
Annuity Programs	7,281 trillion	91,013
Unadjusted Claims International Commitments & other Financial Obligations	59 billion	738
Total	**$11,652 trillion**	**$145,638**

This isn't possible, right? No one could possibly have permitted such a state of affairs to have arisen, right? No additional taxes have been voted for and signed into law to pay for any of this. This is madness, right? All this on top of the usual hundreds of billions per year for national defense, welfare programs, and "normal" operating expenses! Some watchdog in the Congress would have blown the whistle, right? Well, the watchdog (NTU) has blown the whistle for a decade, only the dogs don't come when they're called. They are too busy passing new, unfunded legislation on the assumption that

"STOP THE PRESSES!"

where money is concerned, there's always more where that came from. And there always is. It comes from the Federal Reserve System. The problem with money, however, is that additional supplies of money, unlike other economic goods, do not confer additional social utility when more of it is produced—except for the counterfeiters and their immediate beneficiaries.

The cartoon conveys an important economic fact, the one made famous by Prof. Ludwig von Mises: "Only the government can take something valuable, like paper and ink, and convert it into something worthless." But an underlying presupposition of the cartoon is more specific than the cartoonist suspected (unless he is very sharp): private counterfeiters would stop at this point, but only if they were out of debt. If they could still pay off obligations denominated in paper money, they would not stop the presses. And this is the terrible fact of modern economic life in every Western, industrial nation: *governments have amassed inconceivably large debts.* Furthermore, governments are not constrained by the graph in the cartoon. They will continue to print money in response to the demand of the public, for the public sees the problem in terms of rising prices—rising prices which outrun the ability of each individual or family to keep pace with. The problem is seen as a *shortage of money* in the final stages of mass inflation, as buyers and sellers anticipate the next round of monetary expansion and hike their bids (prices) in advance. The public cries out for more money. The government responds, and prices go up even faster. The bureaucrats are helpless. The government literally can't spew the paper and credit out fast enough to keep up with rising prices, as the German government learned to its dismay and confusion in 1922-23.

But if the government is the primary debtor in the economy, this fact may not disturb the bureaucrats, at least not until their salaries lag behind the salary level of those in the private sector (and eventually, this is exactly what takes place). If the government owes anything near the $11.7 trillion indicated by the NTU figures, the bureaucracy will be less hesitant to pay off its obligations in fiat paper money—what we would call *nominal solvency* but *actual bankruptcy.* This is perhaps the greatest curse of long-term debt: everyone thinks of himself as a debtor, rather than a creditor (i.e., future pensioner, future annuity recipient, etc.), and therefore men are less willing to resist fiat money. The bureaucracy and the politicians need to find a way to pay off their nominal obligations, but there is no way

that future productivity will permit repayment or fulfilment in terms of money with stable purchasing power. There is only one politically acceptable way to default: fiat money. What the Federal government needs is money with real purchasing weakness. What the government wants, the government surely can get. All it has to do is sell its debt to the Federal Reserve System.

The Indexation Dilemma

On the one hand, the Federal government has a vested interest in greater monetary inflation, namely, its ability to pay off existing Federal debt. This is why the favorite Federal statistic among politicians, bureaucrats, and Keynesians, is the ratio between Federal debt and GNP. As nominal GNP rises—fiat-money-induced GNP —the ratio tends to drop, since the denominator (nominal GNP) is rising faster than the numerator (Federal debt, i.e., the cash-balance Federal debt, not the accrual system debt estimate). Thus, things look wonderful. The Federal government really isn't doing too badly after all. Indeed it isn't; but the *creditors* of the Federal government—pension funds, insurance companies, savings bonds owners—are getting *destroyed*. As Milton Friedman so aptly put it, the U.S. Treasury Department is the biggest bucket shop in the world. (A "bucket shop" is a company which sells commodities on margin but does not cover these purchases in cash or futures markets. This is illegal if run privately.) Friedman might have added that Social Security is the biggest Ponzi scheme in the world, i.e., a system that promises to pay high returns, but which pays off to earlier investors with funds collected from new investors. It, too, is illegal if operated privately. But the Federal Reserve System stands behind the Federal Ponzi scheme, guaranteeing that there will never be a day when new sources of pay-out funds are not available for distribution.

On the other hand, the Federal government is presently imperiled by greater price inflation. This is because Social Security payments are tied to a cost of living clause. As the consumer price index (CPI) rises (and with monetary inflation, it won't fall), the Federal debt, especially the accrual system debt, necessarily rises. Increasing benefits are literally bankrupting the Social Security system. They have sold off the Federal debt certificates in the Social Security "trust" fund. They had no choice. This is why the huge increase in Social Security "contributions" became necessary.

But it is not simply the Federal pensioners and Social Security recipients who are "indexed." It also includes millions of union members whose firms have obligated themselves to meet cost of living increases. There will be thousands of bankruptcies if the government does not make available sufficient fiat funds to allow businesses to meet their nominal obligations. Yet this is not going to answer the long-term problem. We now face this crisis: there is the looming problem of "declining real money balances." As inflationary expectations take over, the public bids for goods and services wildly, and *prices rise proportionately faster than the money supply increases.* On the other hand, as we saw in 1975-76 and 1980-82, the policy of monetary stabilization also leads to the "real money" crisis—prices rising faster proportionately than the money supply. The policy of monetary inflation, once it produces high inflationary expectations among the consumers, cannot be stopped without a period of so-called declining real money balances, whether the government adopts mass inflation policies or stable money policies. With millions of laborers tied to a cost of living escalator clause, bankruptcies are guaranteed, for neither the various governments nor private firms will be able to meet their contractual obligations when inflationary expectations take the price level to new levels. They cannot print the money fast enough to keep up. In short, fiat money is only an interim solution to the problem of default. Fiat money can only mask the default in the early and middle stages of mass inflation, *if prices are allowed to rise freely.*

The Politically Inevitable Solution: Controls

The final clause is the tip-off. There is no other politically acceptable solution. The bureaucrats must mask the effects of the masked default (price inflation). They have to escape from the burdensome Federal liabilities that are tied to the cost of living index. Without the stabilization of the official price indices, the Federal government, not to mention private industry, cannot escape the debt burden, for at the end of every mass inflation, prices outrun the expansion of the money supply. *The existence of price indices helps to tear off the mask of nominal solvency, revealing actual default.* But where there is an official price index there is also the possibility of an official solution. *The solution is a price freeze.*

I first offered this thesis on the cost of living escalators in the middle of 1976. It appeared in *Remnant Review* (June 2). *Remnant Review*

is conservative in ideology, and its readers are presumably believers in the free market economy. It was therefore of considerable interest to me to read that Prof. Lester Thurow of the Massachusetts Institute of Technology, the most radical economist who was an advisor to candidate Jimmy Carter (though not, apparently, to President Jimmy Carter), offered a very similar analysis in an essay which appeared on the editorial page of the *Wall Street Journal* some 15 months later (Sept. 12, 1977). He wrote:

> The U.S. economy is not 100 percent legally indexed, but it has rapidly become heavily indexed since 1974 with the introduction of de jure and de facto escalators by government, industry, and labor. Cost of living escalators are increasingly being built into government programs and wages. . . .
>
> Basically there are three policy options. Policymakers could attempt to crack the current system of private indexation by creating truly enormous quantities of idle resources. If policymakers were willing to recreate the Great Depression they might be able to destroy the current system of private indexing, but this would require an enormous price in terms of lost output and private suffering. The second option is simply to sit back and admit that there is nothing that can be done about the inflation rate. Since the economy is almost completely indexed informally, the indexing might as well be made formal to cover those small parts of the economy that are not now protected by cost of living clauses. After all, with indexing, inflation does not hurt anyone—or so the argument goes.
>
> If neither of these solutions is acceptable, the only solution is "income policies." What the income policies have to do is clear. How to do it is much less clear. . . . Converting the current system into a legally indexed system would give the government a handle to reduce the allowable index adjustment below the previous year's rate of inflation, but enforcing such a reduced escalator would be equivalent to wage and price controls.

When Prof. Thurow says that practically everyone is formally indexed, he is not exaggerating. *U.S. News and World Report* (June 9, 1980) estimates that at least 65 million Americans are covered by cost-of-living clauses today. A 1% increase of the cost of living (CPI) increases Federal spending by about $2 billion as a result of the millions of Americans covered. Among those covered:

Social Security	35,300,000
Supplemental Security	4,188,000
Federal civilian retirees	1,712,000

Military retirees	1,308,000
Railroad retirees	1,006,000
Disabled coal miners	416,000
Pensioned war veterans	2,167,000
Postal workers	659,000
Union members under major agreements	5,400,000
Other workers (small unions or nonunion)	2,200,000
State and local-government workers	350,000
State and local-government retirees	1,100,000
Food stamps	20,200,000

The *Wall Street Journal* (March 10, 1976) reported that indexation was spreading quite rapidly. The author of that article made an important point: indexation in the United States always has come in periods of price inflation, and has leveled off or waned in periods of price stability. The implication seems to be that as price inflation accelerates, more and more people will become covered by some sort of indexation clause protection, thereby compounding the problem of price inflation. Equally important are other kinds of contracts besides labor contracts. One purchasing agent—the profession above all others that is alert to price increases—made this comment in the mid-1970s: "Suppliers these days are cranking just about every cost factor imaginable into escalator clauses, from environmental costs and taxes to the wages of janitors in their New York headquarters. They have the equivalent of cost-plus contracts and thus have little incentive to keep down costs." For those of you who do not remember "cost-plus," these were the government contracts of World War II in which war production manufacturers were guaranteed a specified profit on their operations, meaning a fixed profit percentage on total costs expended. This led to guaranteed waste in every line of production: the more waste, the higher the cost; the higher the cost, the larger the total number of dollars received as profit. The cost of living escalator is not quite so bad (since your buyer may go bankrupt if you, the seller, overdo it), but escalators unquestionably lead to a reduced concern about forecasting the future state of the economy as far as prices are concerned. This reduces efficiency.

However, it is my contention that the reason why price controls are coming has very little to do with the public's comprehension of the reduced efficiency of American business. Controls are coming

because of two primary reasons. First, the recipients of the new fiat money expect prices to stay low, thereby enabling them to buy at yesterday's prices with today's new money. But everyone cannot do this if the majority of the population gets access to the newly created fiat money. The auction has to raise prices, and the beneficiaries will cry for controls—to stop the effects of their competitors, who also have access to the new fiat funds. Second, governments in general, and the Federal government in particular, are the nation's largest debtors. They have to shut off the cost of living escalators to prevent fiscal bloodletting. *Once everyone has his own cost of living escalator to protect him, the Federal government will freeze him by freezing all prices.* When most of the economy is on the escalator, it will be shut off. There is no escape in private contracts, at least not in the long run (the 1980s).

Conclusion

By now, you should be getting the picture. Each new economic crisis comes as a result of the most recent "solution" by the Federal government. The bureaucrats in Washington cannot grasp the fact that legislation today is the cause of tomorrow's economic problems, not the cure. The old-timers simply do not learn from experience. Arthur Burns, the former chairman of the Federal Reserve System, was again calling for wage and price controls in March of 1976,[14] just as he called for them in 1970 and 1971. Nixon listened to him in 1971, imposed the controls—against the advice of his own Council of Economic Advisors—and the disruptions of 1971-74 began.

The price freeze will be welcomed by many American business and all state and local governments that are being steadily bankrupted by the cost of living escalator clauses. It will appear obvious to any corporate treasurer or bureaucratic budget director that the continual escalation of prices is *the* threat to his company or his branch of civil government. This drum and bugle corps will join with the pensioners (who worry about rising costs) and consumers whose incomes are not keeping pace with price inflation—a growing segment of the population during an inflationary panic. It will seem so simple: freeze prices by arbitrary dictate and thereby turn off the cost of living escalators.

Of course, there will be black markets ("alternate zones of supply"). Prices on these thin, risky markets will be even higher than

14. *Los Angeles Times* (March 23, 1976).

would have prevailed in an open market. But very few citizens understand the relationship between price controls and black market prices, so the politicians will not suffer from the havoc they have created. They will blame "unpatriotic" hoarders, speculators, and other evil types for "taking advantage" of the poor and helpless. This kind of rhetoric will get them elected. They will not take the blame, so whatever happens to the average consumer who is forced by shortages to deal on some black market, it will not harm the politicians. They can afford to ignore economics, since the voters don't understand economics very well.

More important, prices on the black markets are not recorded in the official statistics that make up the cost of living escalator. These are unofficial prices. The politicians are determined to cement the mask of solvency on the face of real bankruptcy and actual default. The voters will not see through this mask in time to defend themselves. They may think they are paying low prices, but they will have to stand endlessly in lines, or wait forever to get higher on someone's priority list, or actually have to reduce their consumption of the "protected" goods with their artificially low prices. *Ration coupons will become the real form of money in the official markets.* And never forget: the cost of living escalators used by private industry do not (and will not) reflect the value, or lack of value, of ration coupons. No one except the highest bureaucrats will have his income indexed to the real value of ration coupons.

A giant default is coming, and you had better recognize the form it will take. It isn't enough to know that some kind of default or economic crisis is coming; to protect yourself, you have to know *which kind.* Be prepared.

4

SORRY, NO FURTHER BIDS[1]

The auction process seems to me to be the quintessence of market exchange. An economy really is a giant auction, with buyers and sellers assembled together in order to see who is willing to pay the highest price (or offer the most goods) to get what he wants.

The fact we always tend to forget in a supermarket is driven home to us on the floor of an auction: buyers compete against buyers, not against sellers. And since people can always go to another auction, sellers compete against sellers. Keep this rule in mind: *Buyers compete against buyers,* while *sellers compete against sellers.* It is one of the most important lessons of free market economics.

The seller is the spinner of dreams, the master in presenting the vision of previously ignored opportunities, but the buyers always have the option of foregoing yet another dream or potential opportunity. If buyers say no, sellers go hungry.

As you may infer, I like auctions. They fascinate me.

I suppose this fascination with auctions led me to the following fantasy. Imagine the floor of some country auction. Fifteen enthusiastic bidders are standing in front of the auctioneer, who has just brought forth some splendid example of a previously ignored opportunity. The bidders begin to drool.

Imagine also that the rules of the auction are simple. Each bidder has a can full of money behind him, and in order to make his bid, he has to reach into the can, pull out a quantity of paper bills equal to his bid, raise them into the air, and call out his bid. No cash, no bid.

The bidding begins. Everyone meets the opening price of $95 suggested by the auctioneer. He knows now that he has a hot one on his hands. Upward climb the bids, with all 15 participants staying in the competition.

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1. Published in *Commodities* (April, 1979). I have made a few revisions.

Then a most peculiar thing takes place. A man with a uniform begins to dart behind one or another of the shouting bidders, almost at random (yet not quite), depositing newly printed currency in their money cans. Each participant smiles when his refill comes. The bids continue upward. No one leaves the floor.

After the price has climbed steadily to $250, the participants begin to worry. The highest bid ever offered for one of these was $198 back in 1974. Yet the bidding is only warming up. The uniformed man scurries faster, shelling out the cash. Up and down the bidders go, like drunken marionettes, leaning over to grab more cash, standing up again to wave ever-fatter fistfuls of money at the auctioneer.

At $275, some of the bidders start dropping out, grumbling about the insanity shown by others. They start calling for some sort of government regulation of bidding. This panic has to be stopped before it gets out of hand, they say. But the uniformed man keeps scurrying, and the others continue on, undaunted: $300, $350, $475 . . . It's pandemonium on the floor.

Even those still bidding start grumbling. Maybe the government really ought to do something dramatic to bring people (other bidders) to their senses. But not one of them thinks to tell the frantically scrambling man with the money to stop putting new cash in his bucket. After all, that fellow represents the government or a properly chartered agency of the government. He's supposed to know what he's doing.

Besides, each person thinks to himself, "Maybe—just maybe—that guy will stop right after he makes his final deposit in my bucket." But he doesn't stop.

Finally, only eight people are left on the floor. With one breath they cry out a bid and with the other they call for some sort of Federal intervention, such as controls on panic-induced prices. It's up to $750. How long can this go on, anyway? (The answer is fairly simple: About as long as the fellow in the uniform keeps passing out the paper money, plus a few more bids. When the cans are empty, the auction is over.)

Finally, in response to tremendous political pressure from the bidders, a second government official steps onto the floor. This one is wearing a badge. Under his coat there is a bulge, and it doesn't appear to be a wallet. "That's it, ladies and gentlemen," he announces. "No further bids."

At last, the government has acted decisively. The participants are

relieved. The insanity—their insanity—has been officially called to a halt. "The auction has been saved," announces a high-level government official, "from itself."

There is a problem still remaining, however. Eight people are still waiting on the floor, and each one is as convinced as before that the item in question ought to be his. Each one knows in his heart that his next bid would have been the final one, the one which would have driven his competitors from the floor. Now the bids are legally frozen. Each one feels cheated out of what was almost rightfully his.

Question: Who gets to take it home? Another question: What criteria should be used (not to mention *will* be used) to determine who takes it home?

There are several possibilities. There is "first come, first served." Who made that first high bid in the round immediately preceding the freeze? Who was the quickest? (Had he guessed a freeze was imminent? Was he tipped off?)

Another possibility: Who has been coming to this auctioneer's auctions the longest, spending the most money over the years? Who deserves a favor? "Buddy, you've got it!"

Then, again, there's good old Phil Turner. *Sheriff* Phil Turner. "Well, it looks like you've bought it, Phil," says the auctioneer. "I sure hope you like it. Don't forget where you got it."

Of course, there's also the old "39-24-36" method. "You, my dear, just bought the prize. Pick it up in my office right after the auction." A time-honored method, to be sure.

Yet it's altogether possible that the auctioneer doesn't regard any of these approaches as the best. Maybe he decides that this little gem ought to be saved to be auctioned off some other day. Why not take it home? Why sell it at a rigged price in a rigged auction?

Is this fair? Is any of these methods fair? After all, the auctioneer is a profit-seeking seller. "Why should he be allowed to make these decisions?" the "people" may ask.

The official with the badge may call over the official with the cash, ask for a few bills, hand them to the auctioneer and announce: "The people need this. The people shall get it." Then he takes it back to the Washington office.

'Midnight Auctions'

I'll tell you this much. There will be other auctions. The auctioneer will be back. But future auctions will not be advertised

openly. "Midnight auctions" will take the place of open ones. Officials will not hear about many of them in advance. Not the guys wearing badges, anyway.

The money-providing official will be approached by all participants beforehand, each one pleading for his refills before the next auction. Some people will get their money, too, since there's plenty more where that came from these days. The bids at the midnight auctions won't be getting any lower. Count on it.

So if you decide to show up, if only because these will be the auctions where the serious bidders and auctioneers will gather to auction off the only goods worth paying for, then make your plans early. Get a very large can and find one of those money-producing officials. Get your pitch ready now; you'll need a good one.

And for those of you who plan to stick with the open, buyer-protected auctions approved and licensed by the government, come early, and bring a couple of gifts for the auctioneer. In any case, you're only going to get those items left behind by the guys with the badges.

5

INFLATION AND UNEMPLOYMENT

Back in the 1950s, an English economist, A. W. Phillips, investigated the relationship between wage rates and unemployment during several periods of British history. He found that as wage rates rose, unemployment dropped; conversely, when wage rates subsequently stabilized, unemployment increased. Businessmen bid up the price of labor during times of price inflation, competing against one another for the services of working men and women. But when price inflation was reduced, these same businessmen preferred to reduce the number of employees. This empirical relationship between wage rates and unemployment was broadened by enthusiastic Keynesian economists to describe the relationship between "inflation" (meaning price inflation) and unemployment. The graph which describes this relationship has generally become known as the Phillips Curve. When price increases are at a high level, unemployment is low. As the rate of price increases is reduced, unemployment increases steadily. This economic trade-off between price increases and unemployment has become one of the most popular concepts among professional economists, both inside the Federal government and "outside" it, so to speak, in the universities.

It should not be too difficult to understand why this little graph should have become a touchstone for contemporary economists. The Employment Act of 1946—probably the classic piece of Keynesian legislation—requires the Federal government to maintain high levels of employment. This is to be accomplished by the proper fiscal measures. The Federal government is supposed to intervene in the marketplace whenever "effective demand" drops as a result of the individual preferences of those who would trade (or refrain from trading) voluntarily. The State is to increase "effective demand" by buying up strategic items, such as airplanes that do not fly, or even worse, that fly for a little while and then come down very, very fast. Apparently, there is not enough "effective demand" for these items on the free market, and those who produce them often find themselves unemployed when they continue to manufacture them.

The Federal government gets the funds to make these purchases by taxation (direct and indirect) and borrowing. But doesn't this pull money out of the economy that would have been spent anyway? you ask. No sir; it pulls money out of the economy that might have been saved, but saved money is not always invested, and uninvested money isn't being spent, and this reduces "effective demand," so the government spends the money (neither saves nor invests), thus putting people back to work. (You don't understand this because, frankly, you're a bit of a dummy and have never received a Ph.D. in economics from Harvard.) There would appear to be two important laws associated with Keynesian policies of full employment: (1) the government which taxes invisibly, taxes best; (2) try to stay off of Air Force F-111 jets.

The policy-makers believe that when unemployment increases, they can simply crank up Federal spending, and unemployment figures will inevitably tumble. This is an act of faith. Thus, when they confronted certain unpleasant facts, such as 1975's unemployment rate of 9% and price inflation at 8%, they preferred to avoid the implications. They said, for example, "All things considered, I think the calendar year 1975 needs a deficit larger than we have ever had in peacetime. A deficit of 6 percent of GNP would be about $84 billion—frightening to the layman but still 6 percent. The price level in 1980 will be a bit higher with such a deficit than otherwise. But singlemindedly seeking to minimize that price level would logically lead to your favoring continuation of the recession, and even a wish to let it slide into a depression." These words came from Paul

Samuelson, the World's Most Distinguished Economist.[1] By 1980, the world was suffering an international monetary crisis, with price inflation in the U.S. approaching a 20% annual rate in some months and gold hitting $850/oz., followed by a credit controls crisis, a rapid drop in short-term T-bill interest rates, then a rapid increase to 17% mortgage money and a 20% prime rate in 1981, and the advent of the worst post-War recession, worldwide. The "wonders" of Keynesian planning created a disaster.

Ratcheting Disaster

What we are witnessing is a series of escalations between price inflation and unemployment—escalations broken only by major recessions that push up unemployment.[2] The government intervenes each time with baskets full of new money—the invisible tax—in order to increase "effective demand." What it accomplishes, of course, is the *redistribution of wealth* from those who have late access to the newly created money to those who have early access. Those who enter the markets with the new money buy at yesterday's prices. They leave fewer goods and services for those who have not yet been the beneficiaries of the "trickle-down" credit. Prices go up in response to reduced supplies of goods and more money in circulation. But each time government intervenes, those on the tail end of the Federal milk cow start scrambling for the remaining teat. Prices get bid up faster in response to injections of new money, since the public gets smarter about the way to hedge against price increases. The better the public's knowledge, the more rapidly prices respond. "Effective demand" now leads to higher prices. This is not what the planners led the public to expect.

When the economy is depressed, the planners want to increase spending and to lower taxes. This means a larger deficit. But then they face a new problem: *rising short-term interest rates.* The government has to compete in the private capital markets for funds to borrow in order to "fill the gap" between spending and tax revenues. This drains off funds from private investment. Short-term rates begin to climb (the "auction" for money heats up). Private, independent industry is strangled; the State gets too much of the nation's capital. This is not a good way to beat a recession. (It *is* a good way to expand the Federal bureaucracy.) If rates get too high, another

1. *Newsweek* (May 5, 1975).

2. The recession of 1981-82 drove unemployment to 10.8% in December of 1982, the highest level since the tail end of the Great Depression in 1940.

recession appears (e.g., 1980's recession is followed by the 1981-82 recession). So the planners get the Federal Reserve System to create the needed capital, in a desperate attempt to avoid strangling the capital markets. The results are bad. The newly created "capital" is in fact fiat money.

The new money races through the fractional reserve banking system, multiplying happily. Up goes "effective demand," up go the airplanes, and then up go prices. Business "booms," wages go up, everyone is kicked into a higher tax bracket, revenues exceed the forecasts by the planners, and next year's budget deficit is reduced. At this point, the FED generally reduces its purchases of Federal debt. The money supply stabilizes, but the public still continues to bid up prices for a while. Businesses compete to build more plants and build up inventories. Short-term interest rates continue to soar, thus reducing some private entrepreneurial plans to ruins. Finally, investment ceases, laborers are fired, orders are cancelled, and the boom turns into a bust. Down go profits, down go wages, down goes GNP, down go expected Federal revenues, and down go the political incumbents. (What about the airplanes? you ask. Actually, they were grounded—one way or another—six months earlier!) We are back where we started. Only we aren't. We are at a higher plateau.

Former Secretary of the Treasury, William Simon (or, if you prefer, Secretary of the Deficit), put it very well in 1975: "This is the third time in ten years that we have been presented with bills for past Government failures due to irresponsible economic policies. Each time we refused to accept them, and the next time the bills were higher. Just go back and use this simple comparison: In 1970, inflation was over five percent, interest rates at nine and a quarter; last year, interest rates and inflation peaked at about 12 percent. I suggest that if we refuse to pay the bill this time, it will become unacceptably high in the future. I must admit that on occasion, I really question the ability of democracy to beat inflation."[3] Each time, the ratchet goes higher. Each time, the recession is greater and the monetary expansion necessary temporarily to correct it is greater.

When Samuelson in 1975 blandly dismissed higher prices in 1980, he apparently assumed that all we need each time is one more dose of the Keynesian magic. Just one more staggering increase of the money supply, and then we may be able to get back on an even keel. He made no guarantees, however. What we—we?—needed to do was

3. *Playboy* interview (May, 1975).

target for annual real GNP growth at 6%. This was to have been the target "for some time." Admittedly, there were risks. Nevertheless, "The rewards justify the risks." When I think of Samuelson and his ideological colleagues "targeting" a real growth rate of 6%, compounded annually, I visualize an eight year old holding a Ruger .44 magnum in both hands, shouting, "Watch this, Dad!" Yes, indeed, Dad, just watch. From behind that wall.[4]

Hayek's Predictions

The greatest economist in 1982 is F. A. Hayek, Mises' former pupil. He has devoted his life to a study of the components that make possible a free society. In 1974, in the words of a noted Indianapolis leprechaun, John Ryan, Prof. Hayek honored the Nobel Prize Committee by accepting its award; as a result, he subsequently received far more attention than ever before by the press, both in this country and in Europe. As the scholar who first introduced Prof. Mises' monetary theory of the trade cycle to the English-speaking world, Hayek has not deviated significantly from the basic outlines of that theory in the last 50 years. He wrote a pair of splendid articles for the London *Daily Telegraph* (late '74), and his opening statement recapitulated his 40-year accusation against John Maynard Keynes and his followers: "The responsibility for current world-wide inflation, I am sorry to say, rests wholly and squarely with the economists, or at least with the great majority who have embraced the teachings of Lord Keynes."[5]

What aspect of Keynes' theory does Hayek have in mind? His defense of deficits financed by fiat money. Every reputable economist prior to Keynes would have predicted that these policies would lead inevitably to price inflation, Hayek argues. Naturally, the politicians readily adopted a supposed theoretical justification for reducing unemployment by increased government expenditures. But the theory was supposed to apply only when there was unemployment of a very special kind: unemployment without rising prices. "And now, when the steadily accelerating rise of prices has rather discredited this view, the general excuse is still that a moderate inflation is a small price to pay for full employment:

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4. Gary North, "The Theology of the Exponential Curve," *The Freeman* (May, 1970); reprinted in North, *An Introduction to Christian Economics* (Nutley, New Jersey: Craig Press, 1973).

5. London *Daily Telegraph* (Oct. 15, 1974).

'rather five per cent inflation than five per cent unemployment,' as it has recently been put by the German Chancellor."

The chief harm, argues Hayek (following Mises) that the inflation of the money supply brings is the *disruption of relative prices*. Monetary inflation "gives the whole structure of the economy a distorted, lop-sided character which sooner or later makes a more extensive unemployment inevitable than that which the policy was intended to prevent. It does so by drawing more and more workers into kinds of jobs which depend on continuing or even accelerating inflation. The result is a situation of rising instability in which an ever-increasing part of current employment is dependent on continuing and perhaps accelerating inflation and in which every attempt to slow down inflation will at once lead to so much unemployment that the authorities will rapidly abandon it and restore inflation." He might also have added that what is true for labor—a nonspecific resource—is even more true about highly specialized capital goods. Unemployed machines, when financed with 10% or 15% or 20% loans, can produce bankruptcy quite rapidly if they are no longer profitable to operate because of a slowing down or outright abolition of monetary growth. Take a look at a capital intensive industry like the auto industry; consider the electrical utilities, while you're at it. A distorted capital market will misallocate capital on a massive scale—a fact revealed when the expansion of the money supply does not keep pace with the public's expectations of further price increases, and a recession appears.

Thus, writes Hayek, "We have been led into a frightful position. All politicians promise that they will stop inflation and preserve full employment. But they cannot do this. And the longer they succeed in keeping up employment by continuing inflation, the greater will be the unemployment when the inflation finally comes to an end. There is no magic trick by which we can extricate ourselves from this position which we have created." In short, unemployment can no longer be avoided. "The only alternative we have, and which, unfortunately, is not an unlikely outcome, is a command economy in which everyone is assigned his job; and though such an economy might avoid outright worklessness, the position of the great majority of workers in it would certainly be much worse than it would be even during a period of unemployment."

The key, as stated before, is *relative prices*. The attention focused on aggregate prices and wages by statistical indicators has unfortunately

blinded the public, the politicians, and the economists to the crucial nature of relative prices and wages. As he writes in the October 16 issue: "The sort of unemployment which we temporarily 'cure' by inflation, but in the long run are making worse by it, is due to the misdirection of resources which inflation causes. It can be prevented only by a movement of workers from the jobs where there is an excess supply to those where there is a shortage. In other words, a continuous adjustment of the various kinds of labour to the changing demand requires a real labour market in which the wages of the different kinds of labour are determined by demand and supply." Again, his logic would apply equally well to all factors of production. "Without a functioning labour market there can be no meaningful cost calculation and no efficient use of resources." Yet it is the attempt of the State to control the movement of aggregate prices, by means of fiscal and monetary policies, which disrupts the very mechanism of adjustment: the flexible price system.

He thinks that people will learn that inflation-generated increased wages always lead to increased prices. There is little in economic history to support his confidence at this point. Even in the final months of the 1923 German inflation, everyone was calling for more money to catch up to runaway prices. Hayek is far more fearful of the politicians, however. "What is likely to drive us further on the perilous road will be the panicky reactions of politicians every time a slowing down of inflation leads to a substantial rise of unemployment. They are likely to react to it by resuming inflation and will find that every time it needs a larger dose of inflation to restore employment until in the end this medicine will altogether fail to work. It is this process which we must avoid at any price."

Hayek's final sentence indicates the crux of the conflict between Keynesian and conservative economists. Samuelson wishes to avoid unemployment at any price—and the price keeps going up, compounded annually. Hayek wishes to avoid price inflation because he grasps a fundamental truth: it first destroys the capital and labor markets by disrupting prices; it then destroys people on fixed incomes when the buyers race to outbid each other with the newly created money; and finally it destroys almost everyone else when the inevitable contraction and readjustment follow. *Depressions are the product of government-induced monetary inflation.* In the immortal words of Prof. Mises, when asked by a student what the government should have done in 1930, he replied, "The government should have done

nothing . . . earlier."

Hayek calls the shots without hesitation—without adding, as Leonard Cassidy has put it, a string of "unless we's." We have run out of "unless we's" on this side of the catastrophe. An interview with Hayek in *Reason* magazine (Feb., 1975) revealed his fears about the 1975-85 period.[6] He expected more price inflation and the imposition of controls. "What I expect is that inflation will drive all the Western countries into a planned economy via price controls. Nobody will dare to stop inflation in an ordinary manner because as things are at present, to discontinue inflation will inevitably cause extensive unemployment. So assuming inflation stops it will quickly be resumed. People will find they can't live with constantly rising prices and will try to control it (inflation) by price controls, and that of course is the end of the market system and the end of the free political order. So I think it will be via the attempt to regress [repress?] the effects of a continued inflation that the free market and free institutions will disappear. It may still take ten years, but it doesn't matter much for me because in ten years I hope I shall be dead."

As of late 1982, he was still alive, still making intellectual trouble for his socialist opponents. He was premature in his hopes for his own death. He was also incorrect about another thing: price controls. Instead, we have had price inflation, recessions, and high unemployment. He was correct about most of what happened. His prediction of controls will probably prove accurate, but not in the time period he predicted in the *Reason* interview. As with his predictions about the effects of Keynesian policies, he was again premature.[7] Inflation has come, as he predicted for 40 years. Also, paraphrasing Keynes' dictum that "in the long run, we are all dead," in the long run, even the "Austrian School" economists are all dead. But if Hayek lives as long as Mises did, he will not escape the crises he had predicted. Hayek understands that as far as an individual is concerned, Prof. Mises' remark is correct: "There is only one absolutely successful hedge against inflation: age!"

The Other Side of Disaster

Like Hayek, I seldom add "unless we's." Hayek's vision of the

6. *Reason,* 1018 Garden St., Santa Barbara, CA 93101 ($19.50/12 issues).

7. Hayek's predictions about the inflationary effects of Keynesianism are reprinted in *A Tiger by the Tail,* edited by Sudha R. Shenoy (Washington, D.C.: Cato Institute, [1972] 1981).

future is too compelling. It is too consistent with the goals of the messianic State. Thus, I save my "unless we's" for the far side of the disaster, whether it is a mass inflation-depression disaster, or a repressed inflation (controls) disaster. The key to the future is not held by autonomous man. The messianic State is self-defeating. It cannot calculate rationally.[8] It is totally parasitic. Without free men acting responsibly in their particular callings, the modern world would grind to a halt. The international and even domestic division of labor cannot survive under full international socialism. In all of history the socialists have only been able to nationalize successfully one item: socialism. The competing waves of tariffs, quotas, exchange controls on money, capital controls, and all the rest of the tools of modern socialism can lead only to the fragmentation of international trade and productivity. We will be visited by the ghost of the Smoot-Hawley tariff, and the result will be the same: the destruction of wealth. But when the messianic States finally exhaust their resources in an orgy of planning, there will be pockets of resistance. Direct controls—the means of enforcement in a command economy—can be imposed only at the centers of population, and then only imperfectly. The larger the geographical area, and the more dispersed the population, the more costly and inefficient is the control mechanism. It is too easy to buy off the enforcers. Socialist controls do not apply equally well in every region of a large planning region. With the feudalization of the economy, local pockets of free trade can exist.

Conclusion

When the prophet Jeremiah was told that he would have to go into captivity with his people, he was also told to go out and purchase a field (Jer. 32:7-25). It was to serve as a testimony of God's covenant with his people. The destruction of the nation was absolutely inevitable, but so was the ultimate restoration. This is the archetype of every period of trial for God's people.[9] We have a stake in the future.

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8. Ludwig von Mises, "Economic Calculation in the Socialist Commonwealth" (1920), in F. A. Hayek (ed.), *Collectivist Economic Planning* (London: Routledge & Kegan Paul, [1935] 1963); Mises, *Socialism: An Economic and Sociological Analysis* (2nd ed.; Indianapolis, Indiana: Liberty Classics, [1932] 1981), chaps. 5, 6. This was first translated into English in 1936; the first edition appeared in German in 1922. It was first published in the United States by Yale University Press in 1951. See also F. A. Hayek, *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948), chaps. 7-9.

9. Gary North, "Jeremiah's Job" *The Freeman* (March, 1978).

Short-run pessimism is no more to be deplored than short-run optimism. It depends upon the historical setting. Those who are perennial optimists would apparently prefer to expunge the Book of Lamentations from the Bible. They would like to think of Christ's hours in Gesthemene as a chapter 87 of *He Believed in Miracles:* "Jesus Goes on a Picnic." If these people were to produce a movie dealing with the life of Christ, they would probably end it by having a Roman cavalry officer ride up to the cross with a reprieve from Caesar, just before the nails were pounded in.

The only reasonable answer to those people is to tell them to quit dreaming and go to work. And while they're at it, to buy themselves a field, a sword, and a trowel.

6

THE THREAT OF DEPRESSION

When financial writers or newsletter publishers want to catch the eye of the general public, all they have to do is put "depression" in the headline. There is no word in the English language that people respond to faster in the field of economics. Depression is the average American's greatest economic bugaboo.

This sensitivity to the word should not be surprising. Every textbook on U.S. history devotes several chapters to the depression of the 1930s. The typical historian is pro-New Deal, a defender of the domestic policies of FDR, and woefully ignorant about economics. This combination makes it difficult for any liberal to resist the clichés that his equally uninformed senior professor taught him in grad school, not to mention freshman courses in U.S. history back in '58 or '47. The biggest and best cliché of them all was (is) that Roosevelt saved American capitalism from itself. Roosevelt gave capitalism a new lease on life. Roosevelt made capitalism work. There is no dogma in American economic history that is more cherished than this one, for it is this one which supposedly justifies the modern mixed economy. It is by far the most politically successful defense of Keynesian interventionism and inflation. It is believed fervently by businessmen, liberals, civics teachers, government bureaucrats, and financial writers.

The interesting thing is that the textbooks never offer an explanation that shows exactly what it was that caused the great depression —or any depression, for that matter. It was "overproduction" or "under-consumption" that caused it! But why in 1929? Why not in 1928? Why is there any such thing as "overproduction"? Why is production evil? Why does it fail to benefit everyone? Another answer is the great farm crisis. Farmers after 1918, and especially after 1921, never recovered their wartime incomes. All right, they didn't. Why did it take from 1921 to 1929 to produce a depression, especially

when a declining proportion of the population remained on the farm? Why should it have been that in an era of reduced importance of farming in the overall economy that the farmer's income should have been the great determiner of American economic life? Then there was the Smoot-Hawley tariff of 1930. Some writers blame the tariff.[1] This unquestionably made the depression worse, since it reduced the division of labor internationally and domestically. Yet the effect of a tariff is to reduce aggregate production, since it reduces efficiency. But this flies in the face of the "overproduction" explanation of the depression. The depression winds up being caused by overproduction and underproduction. But in any case, Roosevelt cured it. (Or Tojo did, with Hitler's help, since they justified the massive deficits and inflation of the wartime years. Roosevelt's foreign policies may well have helped Tojo and Hitler make their decisions, but this is not what the textbook writers have in mind when they tell us that Roosevelt saved American capitalism from itself.)

There are reasons why Americans fear depression more than inflation, price controls, rationing, and other government-created alternatives to government-created depressions. Here is my explanation. People prefer *continuity* to sharp discontinuity. They believe that it is easier to deal with 5 percent price inflation, or 10 percent price inflation, than it is to deal with 7 percent unemployment, if they themselves are part of the 7 percent. *There is a fear of being 100 percent unemployed.* Price inflation does not hit everyone equally hard, but few people are completely wiped out by price inflation in its early stages (single-digit levels). Everyone, or almost everyone, thinks he can beat the inflation next year if he just gets a few breaks. If he can just keep on working, he can get ahead of the averages. However, if he loses his job, he is doubly cursed: his income stops, but prices keep rising. He falls too far behind to catch up. So he will vote for those who promise a remedy for unemployment. The fact that married men seldom are unemployed for very long, except by choice, doesn't occur to him. What he fears above all is that he will wind up in the ranks of the unemployed. The fear of 100 percent unemployment for those 7 percent is what keeps politicians in office. It's an all-or-nothing proposition. Inflation isn't, at least in the early

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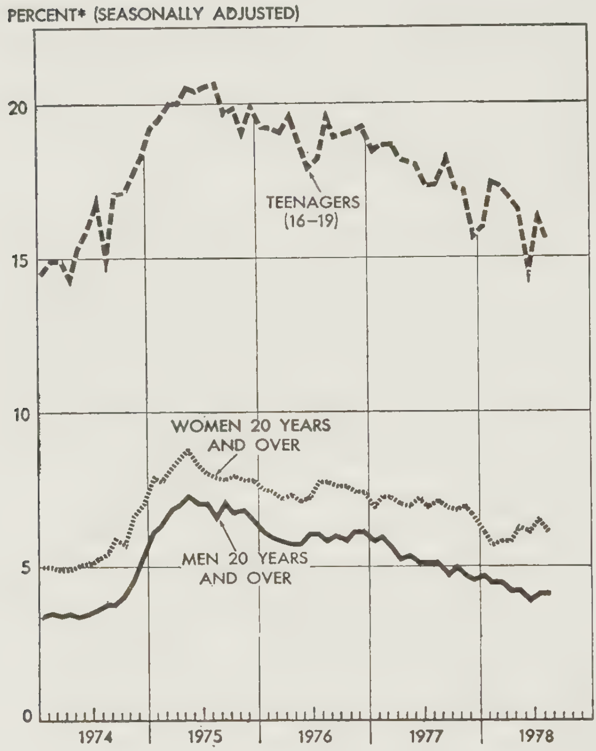
1. Jude Wanniski, *The Way the World Works: How Economies Fail—and Succeed* (New York: Basic Books, 1978), ch. 7.

stages. Men can live with an annual reduction of real income of 6 percent or 10 percent or even 20 percent; what they are unwilling to live with is a reduction of personal status by 90 percent through unemployment. The discontinuity is too great. Massive personal indebtedness makes it all the greater, and today's American is far deeper in debt than his grandfather was in 1932. Leverage is a two-way street, and unemployment puts one on the wrong side of the street very rapidly.

Politically, our willingness to suffer a guaranteed inflation rather than risking the long-shot threat of personal unemployment is sufficient to keep the inflationists in the government saddle. This is why the minimum wage laws are so important to Liberals. These laws keep unemployment high among the "less desirable" members of the labor force, meaning blacks, teenagers, black teenagers, and women. The rise in Social Security taxes will accomplish the same goal, higher unemployment. Then the inflationists will be able to justify even more inflation, in order to lower the real wages of the "less desirable," thereby overcoming the effects of the minimum wage laws. Then indexation takes over, minimum wage levels automatically rise, and the whole process begins again. So what is it that Americans should be afraid of? The politicians.

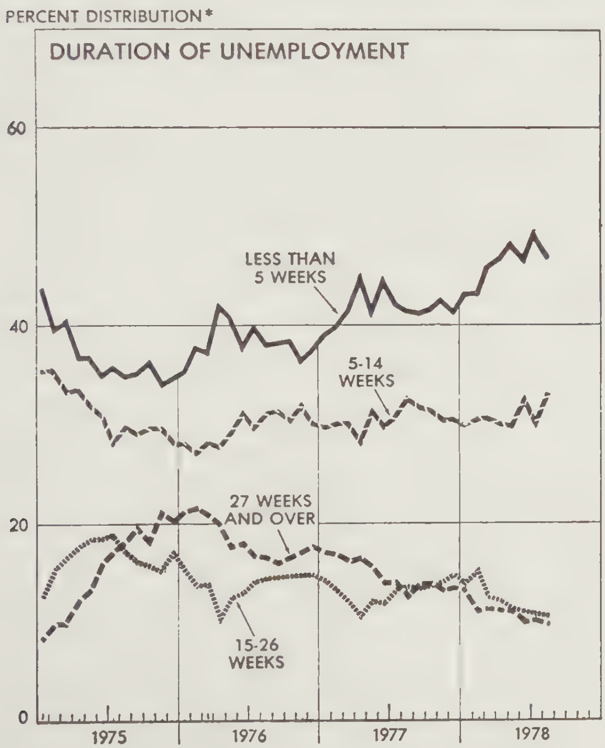
What are the levels of unemployment that so terrify us that we consent to endless doses of "minimum wage law-counteracting" inflation? Take a look. And bear in mind that black teenage unemployment is usually in the 40 percent range, and that married white males—the bulk of the labor force—experience rates under 5 percent. Blacks over age 20 also get jobs. This means that among those people who actually vote, very few are presently threatened by unemployment, yet voters continue to elect inflationists who campaign on a platform of reducing unemployment. The significance of this cannot be overemphasized. It means that a *combination of fear and guilt* can keep the interventionists in power, since envy from the unemployed is not politically effective. Too few of them vote. The old line that "some people work for a living and some people vote for a living" is a good one. Unfortunately, it doesn't get at the heart of the problem.[2] Guilt, not the votes of the covetous poor, is the real problem. This guilt is manufactured.

2. R.J. Rushdoony, *Politics of Guilt and Pity* (Fairfax, Virginia: Thoburn Press, [1970] 1978).



The percentage of unemployed people in the labor force is only part of the story. Consider the far more interesting data concerning *the period that people actually remain unemployed.* While they are unemployed, of course, most of them are drawing tax-free income from the unemployment offices (which are usually called the Department of Employment). The statistics are most revealing. The politicians whose careers are based on their ability to fan the flames of fear surrounding unemployment never point out how few people remain unemployed for more than *five weeks*. About 10 percent of those who are unemployed are out of work for more than half a year, or seven-tenths of one percent of the labor force. One reason why they are counted in the rolls of the labor force is that legislation in 1975 required people on some forms of welfare to state that they are actively looking for work, i.e., that they are still part of the labor force.

They have to lie to get their checks. This is one reason why unemployment is not going to drop much below 5-6 percent, no matter what Washington does. Yet as long as the unemployment statistics report that over 5 percent of the work force is unemployed, Washington will be unable to balance the Federal budget. (The recession of 1980-82 lasted longer than any since World War II, and the average period of unemployment was longer. But this latest recession does not explain the rhetoric of politics from 1946-79.)



When Jimmy Carter ran for President, he promised the voters that he would balance the Federal budget before his first term in office was over. He repeated this promise through the early months of 1977, but by the end of the year he had begun to waver. Ronald Reagan repeated this performance in 1980-81, with the same results.

Now the Treasury makes no such claim. Most government officials have generally given up the balanced budget idea, assuming that they ever accepted it, a highly unlikely proposition. As of late October, 1982, the Reagan Administration once again said it hoped for a balanced budget in 1987, but an unidentified congressional budget source retorted: "It would not be totally out of the question," but given the President's stand against higher taxes and large defense cuts, "you would virtually have to wipe out the basic day-to-day operations of the government, including the courts, Congress, and the IRS."[3] With such an attitude prevailing inside the bureaucracies, pressure from the grass roots to pass an amendment to the U.S. Constitution to mandate a balanced budget is steadily growing, and the Keynesian economists everywhere and bureaucrats in Washington are resisting the move. The U.S. Senate voted to adopt the balanced budget amendment in 1982, but the House rejected it.

It is illuminating to realize that even in the totally gargantuan projections of an "austere" 1983 budget deficit of $200 billion ($30 billion was "austere" in 1977), the statisticians have relied on monetary inflation to push people into higher tax brackets, thereby increasing their tax obligations, which is supposed to boost revenues sufficiently to get closer to that elusive balanced Federal budget. Bear in mind also that there are billions and billions of so-called "off-budget" liabilities of Federal agencies, and the Federal government is supposed to be the insurer of these obligations. This statistical cover-up is very popular in Washington, since very few people are aware of Federal agency debt and its ramifications.

The point I am trying to make is this: the voters, meaning middle-class voters who determine who is elected in this nation, have determined for themselves that inflation of 7% to 9% is less foreboding than short-term unemployment rates of under 5%, the rates faced by the average married, middle-class voter.[4] What will he conclude

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3. Associated Press story, Oct. 22, 1982.

4. The exception: the voter who works in a heavy manufacturing industry and who lives in an extensively unionized, high-tax, heavily regulated state in the northeast. The recession of 1980-82 has hit him harder than previous recessions. His problem is deeper than the business cycle; his problem is that he is in a declining sector of the U.S. economy, and in a declining region of the nation.

if unemployment rates should increase to 10% or 15%, not to mention 25%, such as we had in 1932? What inflation rate would he tolerate then? What policies wouldn't he accept in the name of reducing unemployment? Charlotte Twight gives an answer in her book, *America's Emerging Fascist Economy* (Arlington House, 1975). It isn't a pretty picture.

The characteristics of the traditional depression include these features: (1) falling prices; (2) reduced output of goods and services; (3) reduction of the money supply, because of (4) runs on banks that topple the fractional reserve pyramid of credit money; (5) unemployed resources, including people; (6) falling investment which results in (7) falling interest rates. The depression is a massive correction of the free market to prior interventions by the government into the money supply, namely, a prior monetary inflation.[5] As I mentioned previously, when Professor Ludwig von Mises was once asked by a student what the government should have done about the depression, he replied: "Nothing . . . earlier."

If the government intervenes, especially by creating price controls in the form of price and wage *floors,* then the duration of the effects of the depression will be extended, since the response of men to unemployment—the offering of their resources and services at lower prices—is made illegal by the government. Men are then faced with continuing unemployment; they are then tempted to sell their below-legal price resources (labor) in the black markets. In fact, they have to offer these resources at far lower rates, to compensate the buyers for the risks the latter bear in hiring this below-floor labor or product. This is exactly the position of the illegal Mexican immigrant laborer today. If 2 million or more illegal Mexican aliens stream across the border over the next four or five years—entirely possible, given the crisis of the Mexican economy—this problem will grow worse. There is now serious discussion in Congress of a *national identity card* that employers must check before hiring anyone. The controls do not stop with mere prices and wages. Remember, *price controls are people controls*. When the bureaucrats begin to control people, they never know when to stop.

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5. Ludwig von Mises, *Human Action* (3rd ed.; Chicago: Regnery, 1966), ch. 20.

What I have described is a traditional deflationary depression. It is this form of depression that all Keynesian economists used to think their policies could overcome.[6] In retrospect, it seems incredible that serious men could take themselves that seriously. Bankers in the mid-1960s were reported as being staunch supporters of the "New Economics" of Keynes, with Chase Manhattan's David Rockefeller leading the parade. Americans were told that

1. Bankers, in most cases, show no real alarm at the string of federal budget deficits. Most feel that, at some point in the future, the budget must be balanced. Yet others say that the trail of red ink could continue for years without spelling disaster for Government finances.
2. Paying down the national debt seems no longer to be as urgent a necessity as once was thought. Many bankers now tend to put more emphasis on other things: meeting world-wide U.S. commitments, spurring economic growth, reducing unemployment.
3. Bankers appear solidly to back Government action to head off any business slump with tax cuts and more spending. Old ideas that Government spending could have no effect on business trends or activity have evaporated.
4. Business recessions, say the bankers, are not a thing of the past. But nearly all agree that chances of a major depression—another 1929—are quite remote.[7]

Listen to *Time* magazine, in a December 31, 1965 year-end wrap-up, "U.S. Business in 1965." This is what the public was expected to believe, what the economists told them to believe:

By growing 5% in real terms, the U.S. experienced a sharper expansion

6. A good example of this sort of optimism is a book by an ex-Chairman of the Council of Economic Advisors, Arthur Okun: *The Political Economy of Prosperity* (Washington, D. C.: The Brookings Institution, 1970). Another ex-Chairman, Walter Heller, wrote an equally rosy book, which was in fact a compilation of speeches: *New Directions of Political Economy* (New York: Norton, 1967). A much better analysis was offered by yet a third Chairman, Herbert Stein, who had the misfortune of serving Mr. Nixon when the disastrous policies of the two earlier Chairmen finally hit the economy: *The Fiscal Revolution in America* (Chicago: University of Chicago Press, 1969). An interesting series of "re-evaluations" was published in *U.S. News & World Report* (Sept. 17, 1979), "Answers from Experts: Can Washington Really Manage the Economy?" Those providing "answers" included Herbert Stein, Arthur Okun, and Walter Heller.

7. *U.S. News & World Report* (June 21, 1965).

> than any other major nation. Even the most optimistic forecasts for 1965 turned out to be too low. . . . Basically, Washington's economic managers scaled these heights by their adherence to Keynes's central theme: the modern capitalist economy does not work at top efficiency, but can be raised to that level by the intervention and influence of the government. Keynes was the first to demonstrate convincingly that government has not only the ability but the responsibility to use its powers to increase production, incomes and jobs. Moreover, he argued that government can do this without violating freedom or restraining competition. It can, he said, achieve calculated prosperity by manipulating three main tools: tax policy, credit policy and budget policy. Their use would have the effect of strengthening private spending, investment and production . . . (p. 64).
>
> If the nation has economic problems, they are the problems of high employment, high growth and high hopes. As the U.S. enters what shapes up as the sixth straight year of expansion, its economic strategists confess rather cheerily that they have just about reached the outer limits of economic knowledge. They have proved that they can prod, goad and inspire a rich and free nation to nearly full employment and unprecedented prosperity. The job of maintaining expansion without inflation will require not only their present skills but new ones as well. Perhaps the U.S. needs another, more modern Keynes to grapple with the growing pains, a specialist at keeping economies at a healthy high. But even if he comes along, he will have to build on what he learned from John Maynard Keynes (p. 67B).

Five weeks later, the stock market peaked at just under the 1,000 Dow Jones Industrial Averages level, from whence it plummeted. By the time it returned to that level again, on several occasions (the latest being October, 1982), the purchasing power of the dollar had dropped relentlessly. By 1982, prices were well over three times what they were in December, 1965. So much for the Keynesian miracle.

By the mid-1970s, doubts began to appear in print. "The New Keynesians Have a New Prescription," proclaimed *Business Week* (May 12, 1975). *Time* ran a feature article on August 27, 1979: a cover story, "To Set the Economy Right: The Rising Rebel Cry for Less Government, More Incentive and Investment." It began with a cartoon picturing four men pulling down a bust of John Maynard Keynes from its pedestal. What the critics, such as F. A. Hayek, had argued since the late 1930s, has now become apparent: *Keynesianism*

is essentially an intellectual defense of the fiat money economy.[8]

Older Keynesians have long refused to pay attention to these critics. The hard-core aging promoters of Keynesianism still sing the old songs. Paul Samuelson, author of the best-selling economics textbook and the first American economist to be granted the Nobel Prize in economics, wanted you to take him seriously when he asked (and then answered), "Another Great Depression?" in his *Newsweek* column (Oct. 28, 1975). His answer is typical of the older, self-assured, and increasingly outmoded Keynesian perspective:

> The basic reason why the Great Depression was not inevitable, and why anything really like that depression is impossible now, is that in those days governments all over the world hewed to the lines of orthodox finance. As things got bad, they tightened their own belts and forced the populace to do likewise.
>
> It is more than an empty cliché to repeat that populist democracies all over the world have bitten deep in the apple of the tree of knowledge: we live in the age after Keynes, and there is no going back to Herbert Hooverism.
>
> I see troubles ahead. But not those of the 1930-1933 type.

What kind of depression was he talking about? It is the depression of falling prices and falling aggregate demand. The Keynesians' answer: more fiat money to finance purchases by government and those in cahoots with the government. Today we face a new kind of depression, *the inflationary depression,* meaning the kind of depression which results directly from the policies of the Keynesians. The Keynesians are absolutely baffled by this phenomenon. They have no effective theoretical tools to deal with this kind of depression—a fact which was not recognized by many economists or voters when I first wrote this chapter. The features of the modern, Keynesian depression are these: (1) rising prices; (2) slowing and then reduced output of goods and services; (3) increase of the money supply, the result of (4) the creation of fiat money by the Federal Reserve System to finance (5) the increasing Federal budget deficit; (6) unemployed resources, including people; (7) reduced or falling

8. F. A. Hayek, *A Tiger by the Tail* (Washington, D. C.: Cato Institute, [1972] 1981); Henry Hazlitt (ed.), *The Critics of Keynesian Economics* (New Rochelle, New York: Arlington House, [1960] 1978).

investment which results in (8) falling short-term interest rates, that are followed by (9) rising long-term interest rates that are the result of (10) the increasing inflation premium tacked onto long-term loans by lenders who are trying to evade the effects of a depreciating currency unit. The traditional Keynesian solutions to "depression" only add gasoline to the fire: more government spending, larger Federal deficits, and more fiat money. The intensity of the trade cycle increases. It takes more and more inflation to bring the unemployment rate back down, but only to increasingly higher levels. Both unemployment rates and price inflation rates become "ratcheted," never falling back all the way to the levels that prevailed in the pre-recession period. Each recession is worse; each recovery is weaker.

The "Crash of '79"

Paul Erdman, Ph.D., the ex-Swiss banker and bail-jumper, has treated us to another of his lively novels, *The Crash of '79.* It is a fast-moving yarn, filled with lots of pornography, innuendo, character assassination, and realistic economic assumptions. (Unfortunately, as he later admitted, he got the countries backward: he wrote of a revolutionary coup in Saudi Arabia which led to the destruction of the Shah of Iran. The revolutionary coup came in 1979, as predicted, only it came in Iran.) The book was criticized by liberal financial writers for its realistic economic assumptions, which they invariably called "overdrawn."

What is really overdrawn is the Keynesian intellectual bank account. There has been a run on the Keynesian banks, and there stand Walter Heller, Paul Samuelson, and the *New York Times'* Leonard Silk, telling the fearful depositors not to worry, that there is plenty of capital remaining, only please give them a little more time. "Just one more equation, please," they cry, but the line isn't getting any shorter. It's inside the bank now; if it spills out onto the sidewalk, the Keynesian bankers will be in trouble.

Walter Heller, senior teller at the Bank of Keynes, tells us in the *Wall Street Journal* that the "inflation-adjusted" money supply is shrinking, and that by dividing "the increase in the money supply by the increase in prices, we find the money supply lower today than five years ago." This is the same argument that German government officials, central bankers, and economists gave the German people in 1922 and 1923, as the German mark was falling to 11 trillion to the

dollar (black market price, Nov. 20, 1923). In 1922, Prof. Julius Wolf wrote: "In proportion to the need, less money circulates in Germany now than before the war. This statement may cause surprise, but it is correct. The circulation is now 15-20 times that of pre-war days, whildst prices have risen 40-50 times." In that same year, a German economics journal put this explanation into print: "Now, in Germany, everyone knows that for some months already the note issues of the Reichsbank have been nominally gigantic, but actually they are small, very small if account is taken of their real value, as may be seen by comparing the rise of the note issues with the rise of prices."[9] It was the old, pre-Keynesian rhetoric which was supposed to explain the old, pre-Keynesian inflation. In the late 1970s, it was "the latest stuff" from the Keynesians who did not like to think about Erdman's scenario for the crash of '79.

The key chapter in Erdman's book is chapter 25. Assume the following. Libyan strongman Qaddafi's Marxist-Islamic rhetoric has convinced younger military officers in Saudi Arabia that the present regime has to be scrapped. They find a lower family member who is disgruntled—the typical product of a top-flight American university—and who is willing to allow the military to use him to replace his uncle. The coup is successful. The Saudi government now pulls out all of its deposits from U.S. banks, sells off its investments in the U.S. stock market, and sells off its short-term Treasury bills. It does this deliberately, to "pull the plug" out of Western civilization, which is precisely what Qaddafi's ideology would accomplish. (I would not be surprised to learn that this was what the 1977 summer battle between Libya and Egypt was really all about, a preëmptory strike by Egypt against Libya in response to some sort of Libyan underground infiltration against Egypt, Saudi Arabia, or both. There is no doubt that Qaddafi is the Castro of the Arab world, and it would be naive to imagine that he would not be organizing the training men to infiltrate the military and bureaucratic posts of the richest pro-West Arab nations. I think Erdman's scenario regarding Saudi Arabia is too close for comfort, though I would think that the Saudi Air Force would be the more likely target than the more traditional, feudal army.) Assume also that the public is no longer trustful concerning official statements from anyone in power in this country.

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9. Both citations appear in Constantino Bresciani-Turroni, *The Economics of Inflation: A Study of Currency Depreciation in Post-War Germany, 1914-1923* (London: George Allen & Unwin, [1931] 1953), p. 156.

The stock market begins to break. The bond market follows suit. Huge losses are sustained in the portfolios of the New York banks. The Arabs have dumped their money. Now the Europeans begin to follow their lead. Erdman writes:

> Already back in 1976, the two largest New York banks—the First National City and Chase Manhattan—had been declared problem banks by the controller of the currency. Sure, they tried to correct the situation. They were even taken off that list. But in 1978, the folly of lending long and borrowing short, or lending good money after bad to avoid having to write off bad loans, of pouring billions upon billions into the developing world, lending to governments which could not possibly repay in this century, or maybe even the next, or purchasing the notes and bonds of essentially bankrupt municipalities to keep politicians in line—all such practices had left the banks wide open for a run on their deposits.
>
> But runs never occur in the atmosphere of general prosperity and confidence—especially confidence in the institutions of government. For healthy governmental institutions can save anything in the public mind: even the banks. However, by 1979, public faith in public institutions was approaching zero.

The currency of the United States is backed by the "full faith and credit" of the U.S. government. So are government debt certificates. There has been a massive run on the "faith and credit" reserves of the currency and the debt certificates. The "full faith and credit" reserves are in inverse ratio to the dollar-denominated price of gold. This is why the United States government pressured European governments to set up the London gold pool in 1960, when the first great run on Fort Knox began, and why President Johnson had to set up a two-tier gold price system in 1968. This is why Nixon had to shut the gold window on August 15, 1971. This is why the Treasury sold a token quantity of gold when it went above $175/oz in the spring of 1978: to reduce the extent of this inverse ratio. They are vindictive at the Treasury; they want to get even with gold speculators. But if the scenario set forth by Erdman ever takes place, the Treasury won't have sufficient time or gold to keep the price of gold down. In the short run, they can do it, and all gold buyers should be aware of the fact. Gold might be driven back by $200/oz if the Treasury dumps enough of it. But Erdman's vision will return to haunt the boys at Treasury.

Remember, the justification of Keynesianism is in terms of the

New Deal's "victory" over the old version of depression. The Keynesians have waved the "bloody depression" in front of the voters in the same way that Republicans from 1865-85 "waved the bloody shirt" of the Civil War in front of the voters, to keep them out of the clutches of the less interventionistic Democrats. So the people have never forgotten the great depression, the giant gravestone over the Keynesian corpse. If the great bank run begins, those who have heard the stories of failed banks and wiped out savings will line up. The fact that the problem today is the *failure of money,* not the failure of the banks, will make no impression on them. They have learned their history book lesson. The bank run will precipitate the death of the dollar. Writes Erdman:

> [Says the Chairman of the Federal Reserve System:] "If we start buying up Treasury paper [debt], it will simply flood the market with cash."
>
> "Well, for ******* sake, isn't that exactly what we need?" [Says the President of the United States.]
>
> "Do you realize what you are talking about? This is not money that we are getting from taxes or from borrowings. You are talking about us simply printing up billions and billions of new money, and distributing them in the market."
>
> "Exactly."
>
> "Do you realize where that could lead to? Do you remember what happened in the 1920s in Germany, in Austria, when their governments tried that? The inflation that resulted was . . ."
>
> "Listen," said the President, "I am not interested in hearing any more theories about inflation, or money printing, or any of that stuff. I want action. I will not accept any collapse in the markets for the securities of the government of the United States. Period. And I will not accept one further bank failure in this country. Do you understand?" And his finger jabbed so close to the FED Chairman's face that it damn near shoved his pipe down his throat.
>
> "I . . ." was the start of the response.
>
> "You," thundered the President, "do exactly what I say. Otherwise I will have your ****. If you are not lynched first." The President theoretically had no power over the FED. But if he went public with his case, and if the situation deteriorated, there was no chance whatsoever that the chairman would survive the mob reaction. It was better that he temporarily meet the demands of these economic illiterates and survive, to restore sanity at a later date.

So they printed up an initial run of $25 billion, and flew the cash to

the banks. They knew that this would restore confidence. It didn't work. The debt pyramid was too large.

What no one had ever really thought about in the United States up until that time was the unbelievably huge volume of liquid assets in circulation that could be traded in for cash. Just the value of those shares traded on the New York Stock Exchange amounted to $850 billion. The amounts of Federal Government securities in the public's hands in 1979 represented another $879 billion. The corporate bonds in circulation yet another $750 billion. Deposits in banks—$1,000 billion. Plus the public's holdings of bankers' acceptances, of commercial paper. Etc. Add it all up, and in 1979 there were perhaps $4 trillion in assets which, theoretically at least, could be converted into cash instantly.

What would happen if even 1 percent—just one percent—of these assets were sold, traded in, withdrawn for money—in one day. Well, we found out on March 20, 1979. Chaos. The scenes were frightful on the exchanges in New York, Chicago, San Francisco, and in front of the banks in almost every city and town in the United States. By the dawn of that day $25 billion in new cash had been distributed around the country to thousands of banks. This, together with the normal cash holdings of America's financial institutions, was sufficient—barely, in some cities, but sufficient to meet every demand of every person who wanted cash.

For one day.

Chapter 26 of the book provides the epilogue. This epilogue is Erdman's answer, descriptively, to the "inflation or deflation" debate.

It is estimated that on that Thursday the American public converted well over $100 billion in liquid assets to cash. And on Friday another $125 billion. Within a span of just one week, the total money supply of the United States had been artificially increased, by printing of new money in the amount of $250 billion. Thus the money in circulation in America had essentially been doubled—but not one bank failed. And, with the weekend at hand, there was no reason to believe that the tide would not turn. People would realize that the system had held. And on Monday, very sheepishly, they would start putting their money back where it belonged: in banks, not in their pockets.

But that Friday, and that Saturday, and that Sunday, a new phenomenon developed. Cash in vast hoards was now being converted into tangibles—into food, clothing, gasoline, shoes, houses, horses, furniture. Twice the normal money in circulation was now chasing, in full fury, the same amount of goods which had been there before the madness began.

Soon price was no longer an issue. It was a classic case of instant hyperinflation. It was not the banks that were first forced to close. It was the Safeways, the Sears, the Levitzes. They simply ran out of stock. And on Sunday every McDonald's in the land closed. For their proprietors realized what was slowly dawning on everybody else: the dollar had become a worthless commodity. It was insanity to accept any more. It was the same with the yen, the mark, the pound, the lira. The amounts of these currencies in circulation had risen explosively as a result of the flight from the dollar. Then, as the "American madness" spread, governments everywhere had been forced to flood their countries with even more currencies. Now they were also worthless.

The banks did not open on Monday. In fact, the majority never opened again. For they had been broke long before all this had happened. The run merely brought this truth into the open.

Peace was maintained by the national guard. So the story ends, with the narrator returning to his thousands of acres of northern California ranch land.

Where were the Soviets in the collapse? On the sidelines. Would they really remain on the sidelines? Would their economy break down too? Would their internal repression be able to survive, or would it be made easier by beginning a war of international liberation? The book doesn't speculate. All that survives is land and gold coins.

Can we take Erdman seriously? Yes, I think we can. However, the coming of the psychology of inflation might be slower. If people take money out of the bank to hoard it, fearing collapsing prices, prices might well collapse after the initial stages of monetary inflation. If so, then more money would be drawn out of the banks—until that $4 trillion of liquid assets was converted into $4 + trillion of cash fiat dollars. At some point, the deflation psychology would reverse, but I doubt if it could happen on one weekend.

Erdman's main point is correct: to offset massive net withdrawals, the FED would unquestionably intervene to shore up the sagging market for government debt.[10] This would inject billions into the

10. I stress the word "net." Gross withdrawals are not the main issue. When the Iranian revolutionary government almost withdrew Iranian funds from U.S. banks in November of 1979, President Carter got wind of the plan and froze their accounts. This may not have been necessary. What probably would have happened is this: the Iranians would have deposited this money in British or European banks. These

economy. If cash was needed, then the FED would provide cash. As long as it's fiat money, the FED can supply it, cash or credit. They may not have much faith, but they can offer full credit.

The talk we hear about the non-green secret currency stored in Federal vaults is probably true. There is no direct evidence of it, but why not believe it? What is inconceivable is that such a currency would be substituted, as Dr. Franz Pick has been predicting continually since at least 1973, at a one for 10 or one for 20 ratio.[11] What government ever revalues its currency by knocking off only one zero? Currency revaluations are last-ditch efforts. Governments knock off two, three, or a dozen zeros. Only when the public cannot be skinned with the familiar currency will governments substitute a new, unfamiliar currency.[12] Perhaps the new currency will be distributed in response to the imposition of the Emergency Banking Regulation #1 of 1961.[13] It doesn't matter; the next currency unit will ultimately be accepted because the public determines that it is reliable and useful as a medium of exchange. The best you can hope for is to pay off your old debts with the worthless greenbacks before we get redbacks, or bluebacks, or whatever. Buy gold now.

Conclusion

Erdman's scenario could happen. We might get an initial deflation. I think that the process will be more gradual. War or revolution could speed up the process, but I think we have to bet on gradualism. The debt pyramid will get larger, and the fiat money necessary to finance it will continue to be spewed out. It is a question

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banks would then have loaned the funds back to the U.S. banks—at a profit, of course. Net withdrawals from the Eurocurrency market are seemingly impossible, which is why it has grown from $500 million in 1959 to something in the range of $1 trillion in 1982. This does not count the other Eurocurrencies that operate alongside of Eurodollars.

11. Interview with Franz Pick, Pacific Coast Coin Exchange, *Gold & Silver Newsletter* (May 31, 1973). Today this company is called Monex. The newsletter bearing this title is now owned by Dan Rosenthal, who was a paid editor in 1973. A later version of this same interview is still advertised occasionally by *G&S*.

12. One possible exception: flushing out unreported cash from what is called the "underground economy." Israel did this in the late 1970s when it adopted the new national currency unit, the shekel. So did the Sandinista rulers of Nicaragua shortly after they came into power. If it were done with the dollar—the world's reserve currency—it could create international havoc. If it were done, a chunk of this cash would immediately flow into gold and silver coins and other collectibles—at a discount. The price of the coins would rise rapidly.

13. See Chapter 8.

of fiat money chasing fiat debt. I don't expect deflation in the next 10 years.

I will only say this: there may be a way out. We may be able to avoid a deflationary depression. If we get a *repressed economy,* with price controls, long-term shortages, and rationing, then the economy could be broken. A low division of labor—common to deflationary depressions and repressed inflation—would result. Per capita wealth would continue to decline. If the destruction of exchange and production is widespread enough, then a currency revaluation and the abolition of controls might not produce a depression. As in Germany in June of 1948, when Ludwig Erhard drastically reduced the money supply, by fiat, simultaneously abolishing the price and wage controls, our economy might rebound—if it was completely on its back, with nowhere to go but up. *The Keynesians may yet avoid another traditional depression, simply by giving us something far worse and calling it successful.*

If they do—and I think the politicians will try—then you had better be prepared with a defensive program.

PART II

WASHINGTON'S SOLUTIONS

7

BLUEPRINT FOR TYRANNY

I joined the Washington research staff of Congressman Ron Paul (R-Houston) in June of 1976. Dr. Paul, a physician, had come to Washington in April of 1976, having won a seat in mid-term. His predecessor had resigned to get a new position in the Federal bureaucracy. Dr. Paul lost in November, 1976, by 268 votes out of 193,000, which has to be one of the tighter races in recent years.[1]

A few days after I went on his staff, President Ford issued Executive Order 11921, one of the all-time catalogues of governmental horrors in American history. Few people read it; few people ever will. It is no longer available from the Government Printing Office or from the White House. It is a blueprint for tyranny, only one in a long series of such blueprints that have been drawn up by Federal bureaucrats in preparation for some undefined national emergency in the future.[2] The real emergency will be the imposition of this Executive Order. For those of you who have remained skeptical of what you have read so far in this book, the implications of Executive Order 11921 may remove your skepticism.

The Decline of Congress

To understand the nature of the problem, we have to understand what has taken place to the relationship between Congress and the President. The topic is a vast one, but I think it is significant to make a few comparisons. This term the Congress will introduce about 16,000 pieces of proposed legislation, a figure which includes about

1. He was re-elected in 1978 and is still in Congress.

2. An earlier one was issued by Richard Nixon, Executive Order 11490, which was published in the *Federal Register,* Vol. 34, No. 209 (Oct. 30, 1969), Pt. II: "Assigning Emergency Preparedness Functions to Federal Departments and Agencies." It was published as a paperback book in 1972 under the title, *Blueprint for Tyranny* by Western Islands, Belmont, MA 02178.

1,000 non-binding resolutions. Out of these 16,000, possibly 500 will eventually be enacted into law, or about 3% of those introduced. Some of these bills are virtually automatic, such as raising the Federal debt ceiling or the passage of National Whatever Week. In short, with 535 members on both sides of Capitol Hill working full time, just about one bill per congressional office gets signed into law. For this we can be thankful. It might have been two bills per office every two years.

To accomplish this "vast output" of legislation, hundreds of millions of dollars are expended each year just on staff salaries. A congressman receives $360,000 to hire and run a staff, which is why there is never enough office space for congressional staffs in Washington. Senate staffs cost between $400,000 and $650,000 to operate, depending on the size of the Senator's home state.

Then there are printing costs. A typical daily issue of the *Congressional Record* runs about 200 pages. The *Record* is filled with all sorts of items, such as reprints of articles extracted from the congressmen's favorite magazines and newspapers, or in the case of the late Sen. Wayne Morse, 20 pages of fan mail introduced from time to time. What appear to be printed versions of the debates on the floor are frequently merely pre-printed statements by the members that are inserted so as to make them look like actual speeches. Speeches by members are frantically rewritten by congressional staffs every afternoon to make the speakers look less like incoherent dolts. And each issue of the *Record* arrives on each congressman's desk the next morning. There are few typographical errors. This kind of work is expensive. In fiscal year 1982, it cost $1.3 million.

Then there are the hearings. A few bills on each side of the Hill make it to the hearing stage. Experts are flown in to testify. No one pays much attention to most of them. Then they fly home. If they are big-name experts, they wait a few weeks until the parallel committee on the other side of the Hill takes up a similar bill. They are asked to testify. Still, nobody pays much attention. Both houses of Congress may print up 10 or more 500-page volumes of very similar hearings on the same subject with the same people testifying. But no one reads hearings, and few committee members show up at any given hearing. Sometimes only the chairman of the subcommittee appears, and he may leave for a quorum call, leaving a subcommittee staffer to ask questions. That's when the questions get more intelligent. Then the bill dies. So it gets introduced the next term, and the same process starts over. This can go on for years.

Contrast this process to that of the bureaucracy. Congress slowly passes laws. The bureaucracy implements them. Every day, a book equally as large as the *Congressional Record* arrives at each office, the *Federal Register.* Unlike the *Record,* the *Register* means business. Its fine print is law. Anyone who doubts the scope of the *Register* owes it to himself to order a free sample copy from: Office of the Federal Register, National Archives & Records Service, General Services Administration, Washington, D.C. 20408. Every day of the work week, 52 weeks a year, the *Register* is published—about 60,000 pages a year. This is the law of the land. Congress may have 30 calendar days to "comment" on a law so promulgated. Hearings may be held if Congress comments. Some laws, however, are immediately applied—no comments, no hearings. Congress seldom reverses one of these laws. No congressman has time to read either the *Record* or the *Register,* and few staffs even attempt to keep up on both. What's the use? If Congress gets only 3% of its own proposed legislation into law, what chance would there be of systematically reversing the promulgations of the bureaucracy that are made under the terms of the legislation passed by Congress? So businessmen have to keep a steady eye on the *Register.* Few businesses can afford the legal talent to do this.

The *Federal Register* also includes Executive Orders. There are about 13,000 of these laws on the books today. It takes a two-thirds vote of Congress to overturn these orders, so they do not get overturned. The bureaucracy implements these laws, too. What we are witnessing, then, is a massive defection of responsibility on the part of Congress—a defection which is the necessary concomitant to the quest for total legislation. Congress cannot keep up with the 10,000 bits of proposed legislation it creates for itself, let alone keep up with the executive bureaucracy. By attempting to legislate for everything and everybody, Congress has been brought to the brink of paralysis. It cannot lead, it cannot stop the random moves of the bureaucracy, it cannot even grasp the magnitude of the problem. No one can keep up with even the titles of the publications issued daily by the Federal government. We have seen the fruition of the prophecy made by F. A. Hayek in his 1944 book, *The Road to Serfdom:* the triumph of elitist bureaucrats in the name of participatory democracy. Congress cannot plan Congress, let alone the whole economy. Back in 1944, the academic advocates of "democratic" planning answered Hayek with little more than the refrain, "It can't happen here." What they

meant was, "It can't happen here fast enough to suit us, the academic elite."

Executive Order 11921

This catalogue of horrors was issued as part IV of the *Federal Register,* Vol. 41, No. 116 (June 15, 1976). It reinforces previous executive decrees of this kind, but this pronouncement went farther than earlier versions. It deals with "Emergency Preparedness Functions." Its message is clear enough to anyone who reads it: if the President declares an emergency, you had better be prepared.[3]

Executive Orders began with Woodrow Wilson in 1916, the "U.S. Shipping Board Act." The 1917 Trading With the Enemy Act is still in force. In fact it was under the provisions of this wartime act that F.D.R. closed the banks in peacetime in March of 1933 – a suggestion which Herbert Hoover had given to him, or so Hoover bragged in his autobiographical memoirs. Congress was then told to validate this action, which it did. That "temporary emergency" was not repealed until President Ford belatedly signed a law cancelling it, on September 14, 1976. This 1976 law also cancelled Truman's 1950 declaration of emergency (Korea), Nixon's declaration of emergency in 1970 (Post Office strike), and the one in 1971 (exchange rates). They have a life of their own even after the conditions producing them are long gone.

When Congress began looking into this problem in the mid-1970s, meaning two senators (Mathias and Church), meaning a few staff members from each office, the magnitude of the problem hit with full force. There was and is no catalogue of the President's emergency powers. None. There were 86 volumes of *Statutes at Large* to go through. Fortunately, one branch of government had the foresight to computerize the entire U.S. Code. The Justice Department, right? Wrong. The Library of Congress? Hardly; they can barely even shelve their own books. The Air Force. The records of the U.S. judicial system are in the computers in Colorado. So with the co-operation of the military establishment, Senate staffers went to work. They found a staggering 470 special statutes that can be invoked by the President during a time of "declared national emergency." And he alone has authority to *define* the emergency, at least

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3. President Carter issued a follow-up Executive Order, No. 11953: "Emergency Preparedness Functions," *Federal Register,* Vol. 42, No. 7 (January 11, 1977), Pt. VII.

initially. Sen. Mathias of Maryland was in no sense exaggerating when he testified before a House Judiciary subcommittee in 1975:

> These hundreds of statutes clothe the President with virtually unlimited powers with which he can affect the lives of American citizens in a host of all-encompassing ways. This vast range of powers, taken together, confers enough authority on the President to rule the country without reference to normal constitutional processes.
>
> Under the authority delegated by these statutes, the President may: seize property; organize and control the means of production; seize commodities; assign military forces abroad; institute martial law; seize and control all transportation and communication; regulate the operation of private enterprise; restrict travel; and, in a plethora of particular ways, control the lives of all American citizens.

Efforts by Congress to restrict or reverse the expansion of these powers have been only mildly successful. The morbidly curious can pursue this topic by ordering the following books from the Government Printing Office: *Emergency Powers Statutes,* 93rd Congress, 1st Session (1973), also printed as Senate Report 93-549; *Executive Orders in Times of War and National Emergency,* 93rd Cong., 2nd Session (1974). I realize that only one or two of you can follow through on this, but it should be done. High school seniors in government could have a crack at this kind of project. (Again, I want to stress the advantages of the intellectual division of labor. We need many eyes to keep up with the growing economic and political disasters. Only with accurate analyses can we hope to solve the problems of political action, personal preparation, and timing. Every local church or study group should have a mimeograph machine, even a used one, plus a good electric typewriter that can produce clear, readable copy. *The tighter the screws get, the more valuable will be a decentralized network of information producers, especially at the local level.* The C.B. car radio and the mimeograph machine—if people have stocked up on paper and ink—are the Achilles' heel of any centralized, bureaucratic "emergency" control program, even more than weapons in the hands of citizens. Co-operation requires co-ordination. Guns will be in greater supply in a crisis than mimeograph machines, and the group that can print and distribute information has a real opportunity to influence local events. The Soviet Army's second shock wave always has a man with a typewriter and a mimeograph machine. The war of words is the crucial one.)

How bad is this Executive Order? Very, very bad. Mindbogglingly bad. Anyone who hasn't read anything about these emergency orders has a rude awakening ahead. The day of the Caesar is already on the statute books. It only awaits a set of circumstances, including a risk-oriented President, to inaugurate that day.

To start with, there is total censorship. Not dirty books, you understand. The section on censorship appears under Part 4, the Department of Defense. There is a national Censorship Agreement between the DoD and the Federal Preparedness Agency of the General Services Administration. As far as I am able to determine, the three major control agencies will be Defense, GSA, and Commerce. Section 22 of Part 4 deals with censorship; section 27 with DoD-FCC "plans and programs for the emergency control of all devices capable of emitting electromagnetic radiation." That means your C.B. (citizens' band) radio. Conclusion: let your FCC license for C.B. lapse. By the time you read this, the Federal C.B. license may no longer be required. The job of regulating millions of C.B. radios got too large. Since 50% of the American public supposedly owns C.B. units, it will be very hard for FCC people to trace these signals. The time may come when local communications of defense-minded citizens will be supplemented by the use of C.B. radios. As inexpensive signal-scrambling devices come onto the market, it will become much easier to preserve privacy of communications. Neighborhoods may begin to organize self-defense patrols using C.B. radios. There are many uses that I can think of. Every family needs a 40-channel C.B. unit of some kind, even if it is simply a portable one that plugs into a car's cigarette lighter, such as the Cobra "S.O.S." If Executive Order 11921 ever goes into effect, the bureaucrats may very well try to confiscate private radios that can emit a signal. That's why the C.B. craze is so important for the future. C.B.'s are the "Saturday night specials" of private communications. (See also Part 18, section 5, of 11921.)

The language of the emergency orders has always pointed to nuclear attack. Indeed, the only possible justification of such plans is the destruction of much of the nation over a few days. But the language is misleading—deliberately misleading The opening words of E.O. 11921 are straightforward: "WHEREAS our national security is dependent upon our ability to assure continuity of government, at every level, in any national emergency type situation that might conceivably confront the nation; and WHEREAS effective national

preparedness planning to meet such an emergency, including a massive nuclear attack, is essential to our national survival; . . ." The phrases, "might conceivably" and "including a massive nuclear attack" give the game away. The emergency could be a *peacetime* crisis. The breadth of this legislation can be seen from the following extract, which I reproduce for your reading horror:

(b) The departments and agencies of the Federal Government are hereby severally charged with the duty of assuring the continuity of the Federal Government in any national emergency type situation that might confront the nation. To this end, each department and agency with essential functions, whether expressly identified in this order or not, shall develop such plans and take such actions, including but not limited to those specified in this order, as may be necessary to assure that it will be able to perform its essential functions, and continue as a viable part of the Federal Government, during any emergency that might conceivably occur. These include plans for maintaining the continuity of essential functions of the department or agency at the seat of government and elsewhere, through programs concerned with: (1) succession to office; (2) predelegation of emergency authority; (3) safekeeping of essential records; (4) emergency relocation sites supported by communications and required services; (5) emergency action steps; (6) alternate headquarters or command facilities; and (7) protection of Government resources, facilities, and personnel. The continuity of Government activities undertaken by the departments and agencies shall be in accordance with guidance provided by, and subject to evaluation by, the Director of the Federal Preparedness Agency (GSA).

Part 9, the assignments of the Department of Commerce, indicate just how complete the period of "emergency" controls could be, assuming that the Federal government exercises the powers asserted here.

Part 9—Department of Commerce

Section 901. *Resume of Responsibilities.* The Secretary of Commerce shall prepare national emergency plans and develop preparedness programs covering:

(1) The production and distribution of all materials, the use of all production facilities (except those owned by, controlled by, or under the jurisdiction of the Department of Defense or the Atomic Energy Commission), the control of all construction materials, and the furnishing of basic industrial services except those otherwise assigned, including:

(a) Production and distribution of and use of facilities for petroleum, solid fuels, gas, electric power, and water;

(b) Production, processing, distribution, and storage of food resources and the use of food resource facilities for such production, processing, distribution, and storage;

(c) Domestic distribution of farm equipment and fertilizer;

(d) Use of communications services and facilities, housing and lodging facilities, and health, education, and welfare facilities;

(e) Production, and related distribution, of minerals as defined in Subsection 702(5), and source materials as defined in the Atomic Energy Act of 1954, as amended; and the construction and use of facilities designed as within the responsibilities of the Secretary of the Interior;

(f) Distribution of items in the supply systems of, or controlled by, the Department of Defense and the Atomic Energy Commission;

(g) Construction, use, and management of civil aviation facilities; and

(h) Construction, use and management of highways, streets, and appurtenant structures; and

(i) Domestic distribution of health resources.

If you can think of anything they've left out, do me a favor: keep your suggestions to yourself. Pay special attention to section (f). Next time you hear someone advocating nuclear power, whether public or private, consider the alternatives. Decentralized power is the conservative's best answer, since it is that much more difficult to control from Washington. Nuclear power is Federal power. Yet most conservatives who go into print on the energy question call for extended nuclear power. The conservatives in Congress voted overwhelmingly in 1976 to support a bill to establish Federal loan guarantees for private firms entering the nuclear power field: $8 billion in loan guarantees. These loans will shift private capital into a market that would permit the Federal government to take over all power in the country if, in fact, these power plants worked well. Fortunately, they don't. If Karl Marx were writing the *Communist Manifesto* today, the nationalization of power, meaning nuclear power, would have to be added to his 10 steps to eradicate capitalism. (The vote in the House on this multibillion dollar boondoggle was 193 to 192; the vote had tied, due to conservative support of the bill, and Speaker Albert broke the tie and voted yes.) Marx could have written:

Part 14

(2) *Regulation.* Continue or resume in an emergency (a) controlling the possession, use, transfer, import, and export of atomic materials and facilities; and (b) ordering the operation or suspension of licensed facilities, and recapturing from licensees, where necessary, special nuclear materials

whether related to military support or civilian activities.

What the Commerce Department doesn't get, General Services Administration will:

Part 22

(9) *National industrial reserve and machine tool program.* Develop plans for the custody of the industrial plants and production equipment in the national industrial reserve and assist the Department of Defense, in collaboration with the Department of Commerce, in the development of plans and procedures for the disposition, emergency reactivation, and utilization of the plants and equipment of this reserve in the custody of the Administrator.

(10) *Excess and surplus real and personal property.* Develop plans and emergency operating procedures for the utilization of excess and surplus real and personal property by Federal Government agencies with emergency assignments or by State and local governmental units as directed, including review of the property holdings of Federal agencies which do not possess emergency functions to determine the availability of property for emergency use, and including the disposal of real and personal property and the rehabilitation of personal property.

The phrase, "excess property," is better understood as property owned by "hoarders," meaning anyone who has taken action beforehand and who gets caught. Keep your ideals visible and your strategy quiet.

Naturally, price and wage controls are called for. Big deal.

Remember in 1975 when a bunker of Federal Reserve Notes was discovered in a secret vault in the northern Virginia area? If the boys at the FED have their pile of money buried—yes, money that does not draw interest (Milton Friedman's horror of horrors) why shouldn't you? Why do you need gold and silver coins? Here are a few good reasons:

Part 17—Federal Bank Supervisory Agencies

Section 1701. *Financial Plans and Programs.* The Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Home Loan Bank Board, the Farm Credit Administration, and the Federal Deposit Insurance Corporation shall participate with the Federal Preparedness Agency (GSA), the Department of the Treasury, and other agencies in the formulation of emergency financial and stabilization policies. The heads of such agencies shall, as appropriate, develop

emergency plans, programs, and regulations, in consonance with national emergency financial and stabilization plans and policies, to cope with potential economic effects of mobilization or an attack, including, but not limited to, the following:

(1) *Money and Credit.* Provision and regulation of money and credit in accordance with the needs of the economy, including the acquisition, decentralization, and distribution of emergency supplies of currency; the collection of cash items and non-cash items; and the conduct of fiscal agency and foreign operations.

(2) *Financial institutions.* Provisions for the continued or resumed operation of banking, savings and loan, and farm credit institutions, including those damaged or destroyed by enemy action.

(3) *Liquidity.* Provision of liquidity necessary to the continued or resumed operation of banking, savings and loan, credit unions, and farm credit institutions, including those damaged or destroyed by enemy action.

(4) *Cash withdrawals and credit transfers.* Regulation of the withdrawal of currency and the transfer of credits including deposit and share account balances.

(5) *Insurance.* Provision for the assumption and discharge of liability pertaining to insured deposits and insured savings accounts or withdrawable shares in banking and savings and loan institutions destroyed or made insolvent.

Those people who have high hopes for the stock market had better consider the following warning:

Part 25—Securities and Exchange Commission

Section 2501. *Functions.* The Securities and Exchange Commission shall collaborate with the Secretary of the Treasury in the development of emergency financial control plans, programs, procedures, and regulations for:

(1) *Stock trading.* Temporary closure of security exchanges, suspension of redemption rights, and freezing of stock and bond prices, if required in the interest of maintaining economic controls.

(2) *Modified trading.* Development of plans designed to reestablish and maintain a stable and orderly market for securities when the situation permits under emergency conditions.

(3) *Protection of securities.* Provision of a national records system which will make it possible to establish current ownership of securities in the event major trading centers and depositories are destroyed.

(4) *Flow of capital.* The control of the formation and flow of private capital as it relates to new securities offerings or expansion of prior offerings for the purpose of establishing or reestablishing industries in relation to the Nation's needs in or following a national emergency.

While the E.O. doesn't mention the commodities markets specifically, I think it takes no great leap of faith to imagine what happens when capital, frozen out of the stock market, starts heading for the unregulated commodities markets. Hence, if you have a system for trading commodities, I sincerely recommend that you practice your skills on the London market or some foreign market. Not all of your assets should be in the U.S. and under the supervision of Federal regulatory agencies. A person who is smart enough to beat the commodities markets ought to be smart enough to see what's coming. The *free mobility of capital* implies *free men*—precisely what this Executive Order is intended to remove.

My belief that the GSA is the primary beneficiary of this law is not an unfounded belief. The *Federal Preparedness Agency,* a GSA subsidiary, bears watching. I intend to do my best to monitor it over the next few years. I suggest that you do the same.

Part 30—General Provisions

Section 3001. *Resource Management.* In consonance with the national preparedness, security, and mobilization readiness plans, programs, and operations of the Federal Preparedness Agency (GSA) under Executive Order No. 11051 of September 27, 1962, and subject to the provisions of the preceding parts, the head of each department and agency shall:

(1) *Priorities and allocations.* Develop systems for the emergency application of priorities and allocations to the production, distribution, and use of resources for which he has been assigned responsibility.

(2) *Requirements.* Assemble, develop as appropriate, and evaluate requirements for assigned resources, taking into account estimated needs for military, atomic energy, civilian, and foreign purposes. Such evaluation shall take into consideration geographical distribution of requirements under emergency conditions.

(3) *Evaluation.* Assess assigned resources in order to estimate availability from all sources under an emergency situation, analyze resource availabilities in relation to estimate requirements and develop appropriate recommendations and programs, including those necessary for the maintenance of an adequate mobilization base. Provide data and assistance before and after attack for national resource analysis purposes of the Federal Preparedness Agency (GSA).

Administrators of private schools can rest assured that help will be on the way. The government plans "to assist civilian educational institutions, both public and private, to adjust to demands laid upon

them by a large expansion of government activities during any type of emergency. This includes advice and assistance to schools, colleges, universities, and other educational institutions, whose facilities may be temporarily needed for Federal, State, or local government programs in an emergency. . . ." (Part II, Sect 1106 (2): Health, Education and Welfare). Don't spend all that advice in one place.

Congress reserves the right to reconsider the imposition of a national emergency every six months after a President declares one. However, President Ford directed his Attorney General to look into the constitutionality of this law, and it is questionable in any case if Congress would challenge a President in a declared emergency.[4]

Conclusion

We must also be willing to face up to the grim fact that nuclear war is not unthinkable to the Soviet military leaders. If the U.S.S.R. were willing to take the risk of launching a first strike against our missile silos and Strategic Air Command bases, they would probably succeed in destroying the bulk of our warheads. Our only option would be retaliation against their cities with our remaining missiles, especially our submarine-based missiles. But the U.S.S.R. would probably have over half their missiles in reserve—missiles that would be aimed at our cities. They could announce with near impunity: "If you launch your missiles against our cities, we will immediately launch against yours, and yours are undefended, you have no civil defense program (as we have), and most of your population is in the cities." Would any American President push the button? I doubt it. The Soviet leaders know this. Therefore, the period from now to 1986 will be a time of enormous danger. The Soviets will probably not strike our cities—they want our productivity—nor would they be likely to invade. But an attack on our military installations, especially our missiles, is hardly unthinkable. We have to think about it. The Soviets could neutralize us in an hour. Permanently.[5]

Within 24 hours of a successful strike against our missiles, our government will impose the blueprint for tyranny. Socialist America will at last become a political possibility, perhaps even a reality. In all probability they will impose the Emergency Banking Regulation Number One. To find out what that means, read the next chapter.

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4. *New York Times* (Sept. 15, 1976).
5. Gary North, *The Threat of Nuclear War* (Ft. Worth, Texas: American Bureau of Economic Research, [1979] 1982), $2.

8

EMERGENCY BANKING REGULATION NO. 1

The previous chapter should have warned every reader about the possibilities offered to Federal bureaucrats by the national emergency legislation. The executive orders connected with national emergencies transfer almost total power, officially, to the executive branch of the national government. Of course, total power is never given to man or man's political institutions, but such an exercise of power is nevertheless dangerous to our freedoms. That kind of power will make free market transactions far more difficult and far more expensive, not to mention far less efficient.

The previous chapter merely skims the surface of the national emergency laws. There are hundreds of them, some of them buried deep in the Federal bureaucracy, invisible until they are implemented in the name of an emergency. One of the most revealing pieces of evidence in this regard is almost impossible to locate, but I was given a copy in the mid-1960s. It is the transcript of the Economic Stabilization Conference which was held at the Ambassador Hotel in Los Angeles on September 12, 1961, not long after the Berlin crisis of Kennedy's administration began. It was sponsored by several organizations, including the L.A. Office of Civil Defense, the California Savings & Loan League, Teamsters Local 42, the L.A. County Federation of Labor (AFL-CIO), and the L.A. Chamber of Commerce. This was not a minor conference. The real sponsor, however, was the Office of Civil Defense Mobilization (OCDM).

By the time this traveling road show hit Los Angeles, there had already been three other performances in different cities. The civil defense bureaucrats were trying to mobilize local bureaucrats to serve as front men for the Federal government during a time of attack. Regional officers in Federal planning agencies were brought before the audience to announce a vast new scheme of Federal

administration. The official excuse for this centralization of power was national defense during a time of attack. Obviously, most people think of nuclear war when they hear the word "attack." Not so in the minds of Federal planners. To limit the word "attack" to a nuclear exchange would be to limit the intrusion of the Federal power into local affairs. "Attack" is deliberately left undefined. This means that the ability of the President to impose the control system is left "flexible," which is another word for "arbitrary." For example, if the Soviet Union tried to block the shipping of Middle East oil to this nation, or to our European allies, would this legally constitute an attack on the United States? It probably would, and if the President were to declare a national emergency on this basis, the whole structure of national emergency regulations could be implemented.

Consider the words of Edward Phelps at the 1961 Los Angeles conference. He was the Deputy Assistant Director for Economic Stabilization of the Office of Civil and Defense Mobilization. His view of the Federal government's role is straightforward. Furthermore, notice the difference between local political power and Federal power in a nuclear attack as compared to a conventional attack. The latter, seemingly less destructive, will pass far greater power to the Federal planners:

> If we are going to keep our economy functioning, solvent, if we are going to stabilize it following an attack, the people of the country who survive are going to have to do the job! Not a big, benevolent, all-seeing, all-powerful Federal Government. On the other hand in a case of limited war, this all-seeing, benevolent, all-powerful Federal Government will do this kind of work, because it is able to do it and is required to do it, . . . and has the capacity to do it! (p. 34)

I have quoted him exactly as his words appear in the transcript, even including the three dots. His view of the ability of the Federal planners to control ("stabilize") the economy is too typical of those who serve in the government. He is referring to a limited war.

Robert W. Winsor, another Economic Stabilization Officer with the OCDM, but in this case at a regional office (Santa Rosa, California, Region 7), announced the following plan. For the first five days after an attack on the United States, there will be no retail sales of food, petroleum products, or other consumer goods except perishable goods, and then only on a limited basis. Food will be rationed by local governments on a bag by bag, family by family

basis (pp. 26-27). The local rationing boards will do their work only until the Federal government can get organized to ration everything nationally. "The last phase of rationing operations would involve the gradual and eventual consolidation of local-state operations by the federal government. National policy assumes that this would take several months" (p. 27). He was very specific on one crucially important point: *there must be no alternative zones of supply.* "There must be no supply of the rationed item available except through the rationing system" (p. 28). In short, the government, and only the government, should be allowed to keep people alive. People must depend exclusively on government for their survival, first the local government and then the Federal government.

The bureaucrats occasionally let the cat out of the bag. They keep talking about war, or attack, or some military crisis when they seek to justify the creation of a control system. But once in a while the broad nature of their definition of a justifying emergency creeps out. Claude Phillippe, then an Assistant Supervising Examiner of the Federal Deposit Insurance Corporation (bank account insurance), District 12, used the words "or any emergency," in a revealing way:

> First, let me emphasize that regardless of the circumstances which may result from an enemy attack, or any emergency, it is intended for our banking system to continue to function in the post-attack period in accordance with usual procedure, subject, of course, to rules and regulations deemed necessary in the interest of the economy and war effort (p. 58).

Translated from the original Bureaucratese, this means that nothing resembling "usual procedure" is likely to survive the attack, or "any emergency," and new "rules and regulations deemed necessary" will confiscate the wealth of Americans on an unheard-of scale.

Am I exaggerating? Listen to Edward Phelps again. He is a classic environmental determinist who wants us to believe that we have no choice in choosing this new system of controls. "This world is changing. I guess we are changing with it, and we haven't any choice but to learn to live in the environment surrounding us." This means that we have to do it the bureaucrats' way. The Cold War will go on, he said. Therefore, again stressing our lack of choice, "we have no national choice but to learn to live in a new kind of world and to prepare ourselves to respond to whatever may happen" (pp. 9-10). But this "new kind of world" is really the ancient system of central political control which has been popular with rulers and bureaucrats

since the days of Egypt's pharaohs. Phelps says that we have four, and only four choices, and we have to choose the fourth. Watch this sleight-of-hand (mouth?) routine. First, we can do nothing, make no national plans, and wait for an attack. Second, we can let people barter after the crisis, meaning we can leave men free to create their own alternative currency system—a terrifying thought. "Whatever it might be, it wouldn't be our system as we know it. It would be a new and substitute one! Well, this has been ruled out and oversimplified, merely because we are so conditioned to our economic way of life. . . ." Third, we can have an authoritarian control system. That is out, of course. Fourth, we can accept this new controls system of the "benevolent" Federal government, to use his term. He calls this system a "going concern." He is quite explicit: "It would be a regulated system beyond our past powers to imagine regulation, I suppose" (p. 14). That takes some imagination! But, of course, it would be our system (ours?) and therefore not tyrannical: "But it would be our system and it would be a 'going concern.'. . ." A "going concern" like this used to be called fascism.

This "going concern" will involve a system of *comprehensive price controls.* The controls are to be imposed by local governments first. Mr. Phelps spelled out the program:

> So, therefore, I will simply say that the basic objective of what we are trying to accomplish in localities and communities is to develop a capability on the part of those communities "to hold the line" with respect to prices and rents for as long as it takes to let the country organize itself and let the federal government organize itself so that it (the federal government) can gradually assume its basic responsibilities and take over or weld together the first temporary interim responses by local and state people!
>
> Local and state people, you understand, will be impotent unless business, professional and financial people are helping them in undamaged areas. For the latter have the know-how and experience!
>
> In general, the basic goal of our suggested guidance to local and state authorities is simply that a freeze of prices and rents be imposed, a self-triggering freeze, which will accompany self-triggering action taken in undamaged areas with respect to banks and financial institutions (p. 33).

Banks and financial institutions: here is the key. *The authorities must have control of the banking system if they are to control prices, eliminate the black market, and control the population.* This control is now waiting to be

imposed. It is called the Emergency Banking Regulation No. 1. It was signed by the Secretary of the Treasury on January 10, 1961, and it received virtually no publicity. But speakers at this conference knew all about it and referred to it constantly as a major weapon in the war against "chaos," meaning the free market.

The Story of a Secret Document

Robert B. Anderson, who was President Eisenhower's Secretary of the Treasury, signed the Emergency Banking Regulation No. 1 just before President Kennedy took over. The document, we learn in the conference's proceedings, was sent to "all of the banking offices in the United States as well as to certain other interested parties" (p. 52). But you have never heard of it, right? Neither has your congressman or senator.

When I mentioned the existence of this regulation to a friend of mine who held a high position in the Washington congressional research structure, he was dumbfounded. He had never heard of it. Yet his specialty is American banking legislation. He immediately contacted the Treasury Department. He was told that such a regulation does not exist. He assigned a Library of Congress researcher to find it, and the man found absolutely nothing.

My friend grew suspicious. The document didn't bear the Treasury Department's official letterhead. It was printed on white paper with "Department of Treasury" typed in, not printed. He thought it might be a forgery. But when I sent him a copy of the Economic Stabilization Conference and certain other evidence, he concluded that it must be legitimate. But Treasury denied any knowledge of it.

Finally, he was able to get an official answer. The regulation did exist, and it was signed, but since the regulation is implemented only when the President declares an attack on the country, there is no law on the books. *There was therefore no record of it anywhere in the files available to the public, including the U.S. Congress!* If a California lady who supplied me with the documentation hadn't been diligent back in 1963 in collecting this document and the supporting evidence, no one would now know of its presence—no one except those bureaucrats who stand ready to implement it.

The public, the public's representatives, and even the President have only the faintest glimmer of the massive pile of secret legislation ready to be imposed on this nation in the name of national

emergency. It is a frightful legacy.[1] This is why I recommend that you read my book very carefully and take steps to protect yourself.

Since 1916, Congress has permitted presidents to issue Executive Orders, thereby transferring huge chunks of the legislative sovereignty of Congress to the Executive branch. If Congress is unwilling to defend its own sovereignty from the Executive, then it is unlikely to defend the sovereignty (freedom) of citizens from the Executive. You are on your own.

How to Protect Yourself

I happen to have dug out this regulation with the help of my California contact. There are undoubtedly thousands of other similar regulations sitting in dusty files, invisible to the public, waiting to be implemented. This is why you have to be prepared for events that most Americans think are impossible.

When you read the full, dull text of the Emergency Banking Regulation No. 1, you had better read Chapter V of the regulation very carefully. Then you had better take steps to get a supply of dehydrated food for your basement storage facility. You had better put some cash aside. You had better be sure that all of your easily marketed assets are not in your safety deposit box. (Your wife should own the box, and she should pay for it with her own personal, exclusive checking account. This way, the authorities will not seal the box at the time of your death. This one tip could save some readers the price of this book, if they take my advice. Remember, the Internal Revenue Service can legally break into anyone's safety deposit box to search for incriminating evidence, the U.S. Court of Appeals for the Second District—New York City— has determined *(Inflation Survival Letter,* April 20, 1977.)

Never forget: the government reserves the right to ration your own money back to you. You had better own some "alternative money" that the government will have difficulty rationing.

Here, then, is the document which the Treasury at first denied

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1. When I ran a national advertising campaign in 1979 to warn the public about this regulation—and also to generate new subscriptions to my newsletter, *Remnant Review*—congressmen were flooded with inquiries from voters. Did such a regulation exist? Some congressmen denied it, others discounted its importance. Interestingly, many sent it to the office which is supposed to monitor such matters. Guess who wound up answering their inquiries? Right: my contact inside the department who had initially been told by the Treasury that it did not exist. He wrote back to each congressman and told them it really does exist.

ever existed and the Library of Congress could not locate in an intensive search. I have also reprinted Secretary Anderson's cover letter which summarizes the regulation.

Department of the Treasury

Statement of
The Secretary of the Treasury to accompany
the issuance of the
Emergency Banking Regulation

In keeping with the objectives of the National Plan for Civil Defense and Defense Mobilization, I have issued an Emergency Banking Regulation that would become effective only in the event that there would be an attack upon the United States. Issuance of the Regulation at this time has no particular significance except that, after months of careful study, work on it has now been completed. It is being issued so that banking institutions may develop and complete their emergency preparedness programs as advocated by the National Plan.

Obviously the effective utilization of the financial capacity of the Nation in the conduct of any war that might befall us must be assured. The Regulation provides, insofar as possible, a reasonable degree of flexibility, as proper implementation would depend heavily upon the knowledge, initiative and judgment of the managements of our financial institutions and the understanding and cooperation of depositors and share or savings account owners. Basically the Regulation is for the purpose of assuring the maintenance of operations and functions of all banking institutions, including savings and loan associations and credit unions, and to facilitate restoration of such activities should they become temporarily disrupted because of such an emergency. This Regulation, should it ever become effective, would be subject to such amendment, modification or termination as might be consistent with the existing monetary needs and the developments in the national economy.

The Regulation has been issued pursuant to the authority vested in me as Secretary of the Treasury, including the authority vested in me by Section 5 (b) of the Trading with the Enemy Act of October 6, 1917, as amended (50 U.S.C. App. 5 (b)), and Executive Order No. 9193. Bearing in mind that the Regulation would become effec-

tive only in the event of an attack upon the United States, and that the term "banking institutions" includes every commercial bank, trust company, private bank, savings bank, mutual savings bank, savings and loan association, building and loan association, cooperative bank, homestead association, credit union, and United States Postal Savings depository office authorized under the laws of the United States or any place subject to its jurisdiction, or any receiver or conservator for any of the foregoing, the Regulation is summarized as follows:

All Federal Reserve Banks, Federal Home Loan Banks, their respective branches, and all banking institutions and their branches would be required to remain open and continue their operations and functions, and permit the transaction of business during their regularly established hours. The only exceptions would be those unable to operate because they may have suffered personnel losses or physical damage, or may be located in areas declared to be unsafe because of defensive or enemy action. Such institutions would also be authorized to act as agent for each other in carrying out their operations and functions. Banking institutions and depositors and the owners of share or savings accounts would be required to observe provisions that would guard against the misuse of the Nation's monetary resources so that they might be preserved primarily for the payment of vital expenses, reconstruction and essential living costs, taxes, or payrolls. Provisions would also guard against the misuse of credit by directing all lending activities toward the above-named essential purposes.

To prevent misuse or hoarding of goods and material and in order to guard against inflation, government planning also includes a number of other emergency measures. These would provide for the stabilization of rentals, prices, salaries, and wages, and rationing. During an emergency of the type toward which our planning is directed, the cash and credit resources of our financial institutions must likewise be utilized to the end that the best interests of the Nation would be served.

Robert B. Anderson
Secretary of the Treasury

Dated: January 10, 1961

Department of the Treasury

Emergency Banking Regulation No. 1

Chapter I

Authority

This Regulation is issued pursuant to the authority vested in me as Secretary of the Treasury, including the authority vested in me by Section 5 (b) of the Trading with the Enemy Act of October 6, 1917, as amended (50 U.S.C. App. 5 (b)), and Executive Order No. 9193.

Chapter II

Time of Taking Effect

This Regulation shall be effective immediately after an attack upon the United States.

Chapter III

Definitions

(a) As used in this Regulation, the term "banking institution" shall include the following banking and financial institutions: every commercial bank, trust company, private bank, savings bank, mutual savings bank, savings and loan association, building and loan association, cooperative bank, homestead association, credit union, and United States Postal Savings depository office authorized under the laws of the United States or of any State to transact business in the United States or any place subject to its jurisdiction, or any receiver or conservator for any of the foregoing.

(b) As used in this Regulation, "operations and functions" shall include the paying out or earmarking of any coin or currency, or permitting the withdrawal or transfer therof in any manner or by any device whatsoever; the receipt or paying out of deposits; the receipt of payments into share or savings accounts or the repurchase of or payments on withdrawals from share or savings accounts; the

making of loans or discounts; transfers of credit; the performance of fiduciary, custodial or agency functions; the purchase or sale of securities, and the transaction of any banking or trust business whatsoever.

(c) As used in this Regulation, the term "Branch" shall include any duly authorized place of business separate and apart from the head office of a Federal Reserve Bank, Federal Home Loan Bank, or banking institution in which any of its operations and functions are carried out.

Chapter IV

Continuance of Operations and Functions
Temporary Curtailment of Operations and Functions
Temporary Quarters, and Emergency Loans

Section 1. *Continuance of Operations and Functions of Federal Reserve Banks, Federal Home Loan Banks, Banking Institutions, and Branches.* Except as provided in Section 2 of this Chapter, all Federal Reserve Banks, branches of Federal Reserve Banks, Federal Home Loan Banks, branches of Federal Home Loan Banks, and all banking institutions and all branches thereof, without regard to whether or not the head office or any other branch or branches are functioning, shall remain open and continue their operations and functions and permit the transaction of business during their regularly established hours.

Section 2. *Temporary Curtailment of Operations and Functions.* Any Federal Reserve Banks, Federal Home Loan Bank, banking institution, or branch may temporarily curtail, limit, suspend, or delegate any or all operations and functions if located in an area which is unsafe because of enemy or defensive action, or if essential personnel or physical facilities become unavailable. Operations and functions of any Federal Reserve Bank, Federal Home Loan Bank, banking institution, or branch which have been so curtailed or suspended shall, as soon as practicable, be resumed when the cause of such curtailment or suspension has been remedied, removed or dissipated.

Section 3. *Temporary Change of Quarters.* In the event that the main office or any branch of any Federal Reserve Bank, Federal Home Loan Bank, or banking institution becomes wholly or partially unusable, as a result of an attack upon the United States, the Federal Reserve Bank shall, if possible, establish temporarily necessary

substitute quarters. The use of such substitute quarters shall be terminated as soon as practicable.

Section 4. *Loans to and Borrowings from Federal Reserve Banks, Federal Home Loan Banks, or Banking Institutions.* In order to provide the necessary liquidity to maintain operations and functions as required by Section 1 of this Chapter, any Federal Reserve Bank, Federal Home Loan Bank, or banking institution, or branch thereof, may make loans, discount assets, or borrow without regard to the restrictions of Federal or State law.

Section 5. *Notification of Supervisory Authorities.* Any banking institution or branch thereof which curtails or suspends its operations and functions or changes the location of its quarters pursuant to Section 2 or 3 of this Chapter, shall as promptly as possible notify all of the authorities responsible for its supervision, State and National, and if the banking institution is insured, such supervisory authorities shall notify the Federal Deposit Insurance Corporation or Federal Savings and Loan Insurance Corporation, as the case may be, of all such actions by banking institutions or branches thereof reported to them.

Section 6. *Action As Agent.* Any Federal Reserve Bank, Federal Home Loan Bank, banking institution, or branch may by agreement act as agent and perform temporarily any or all operations and functions of any other Federal Reserve Bank, Federal Home Loan Bank, banking institution, or branch.

Chapter V

Restrictions on Cash Withdrawals and Transfers of Credit

Section 1. *Cash Withdrawals.* (a) Withdrawals in the form of cash, whether by the cashing of checks or drafts, the making of loans in cash, or any other form of cash disbursement are prohibited except for those purposes, and not in excess of those amounts, for which cash is customarily used.

(b) Banking institutions are further authorized to restrict and ration cash withdrawals to the extent necessary in the event a sufficient amount of cash should not be available.

(c) Banking institutions shall prohibit withdrawals of cash in any case where there is reason to believe that such withdrawal is sought

for the purpose of hoarding.

Section 2. *Transfers of Credit.* (a) No depositor or share or savings account owner may transfer in any manner or by any device whatsoever any balance to his credit on the date on which this Regulation becomes effective, except for the payment of (i) expenses or reconstruction costs vital to the war effort, (ii) essential living costs, (iii) taxes, (iv) obligations incurred before the date on which this Regulation becomes effective, to the end that the best interest of the war effort and the public will be served.

(b) Banking institutions shall prohibit the transfer of credit in any case where there is reason to believe that such transfer is sought for any unauthorized purpose.

(c) After this Regulation becomes effective, banking institutions shall retain until released by Federal authority the original or photographic copy (face and reverse sides) of each check and other evidence of transfer of credit in the amount of $1,000 or more.

Section 3. *Exceptions to Restrictions.* (a) Balance in deposit or share or savings accounts may be transferred from one banking institution to a deposit or share or savings account of the same owner in another banking institution.

(b) The restrictions of Section 2 of this Chapter shall not apply to any check or draft negotiated for value prior to the time this Regulation becomes effective.

(c) The limitations and restrictions of this Chapter shall not apply to the United States, any State or any political subdivision thereof, nor to their respective agencies and authorities.

(d) The limitations and restrictions of this Chapter shall not apply to transactions between Federal Reserve Banks, Federal Home Loan Banks, banking institutions, and branches thereof.

(e) The provisions of Section 2 of this Chapter do not alter the right of any banking institution to invoke restrictions on withdrawals of deposits or repurchases of or payments on withdrawals from share or savings accounts provided for under contract or agreement with depositors or share or savings account owners or by reason of law or by the provisions of its charter or bylaws.

Chapter VI

Lending and Extending Credit

Section 1. *Making Loans and Extending Credit.* No banking institu-

tion may make any loan, extend any credit, or discount or purchase any obligation or evidence of debt, unless it is established and certified in writing by the borrower and a banking institution that the purpose is to pay (i) expenses or reconstruction costs vital to the war effort, (ii) essential living costs, (iii) taxes, or (iv) payrolls, to the end that the best interest of the war effort and the public will be served.

Section 2. *Exceptions to Restrictions.* (a) The restrictions contained in Section 1 of this Chapter do not prohibit the renewal, recasting, or extension of any loan or credit outstanding prior to the effective date of this Regulation, if in the judgment of the management of the banking institution such action is in the best interest of the war effort. The cancelled original evidence of debt shall be attached to the instrument renewing, recasting, or extending such obligations.

(b) Section 1 of this Chapter shall not apply to loans or extensions or credit to the United States, to any State or any political subdivision thereof, nor to their respective agencies and authorities, nor to loans or extensions of credit between banking institutions.

Chapter VII

Savings Provisions

Any action authorized or required to be taken by a Federal Reserve Bank, Federal Home Loan Bank, banking institution, or branch or its management pursuant to this Regulation may, in the absence of persons authorized by delegation or otherwise to take such action, be taken by any director, officer or employee of such Federal Reserve Bank, Federal Home Loan Bank, banking institution, or branch at the time conducting that part of the affairs of the Federal Reserve Bank, Federal Home Loan Bank, banking institution, or branch to which such action relates. Notwithstanding any other provision of law, no Federal Reserve Bank, Federal Home Loan Bank, banking institution, or branch or any director, officer, or employee thereof and no member or employee of any agency of the United States shall be subject to any liability on account of any action taken or omitted to be taken in good faith pursuant to this Regulation, provided that this sentence shall not be deemed to apply to any liability on account of any contractual obligation.

Chapter VIII

Revision or Termination

This Regulation may be revised or terminated when so ordered by the Secretary of the Treasury.

Robert B. Anderson [signed]

Secretary of the Treasury

* * * * *

Postscript

I sent a copy of my report on Emergency Banking Regulation Number 1 to one of the most distinguished legal theorists in the United States, a law professor who teaches law professors. He is also one of the most determined anti-bureaucrats in the country. I had not expected any reply, but he sent me the following letter in the summer of 1977. I have edited it to protect the innocent, but otherwise it is unaltered. I would hasten to add that the scholar in question is not a proponent of a conspiracy view of history, which makes his final remarks all that more interesting.

In 1962 I undertook a large scale project for the [prominent think-tank] on "Post Nuclear Attack Economic Planning by the Federal Government." I knew about Emergency Banking Regulation No. 1 and a vast many other pieces of idiocy equalling or even surpassing that one in potential danger or simple wrongheadedness. I concluded at the end of the study that the only thing that could save us from a post attack disaster worse than the effects of the attack was the fact that none of the plans could ever be coordinated or made to work. I confess that I had not noticed that any of these regulations could go into effect without a nuclear attack, and I am not sure of the validity of any of these regulations other than under such emergency war powers.

Well, I did that extensive study with the help of a couple of law students and without seeing any classified materials. However, when the finished study was presented to the Office of Emergency Planning it was immediately stamped "Top Secret," and I haven't seen it since. I know that they threatened to take all contracts away from [the institute's director] unless he revised it, but I don't know what happened thereafter.

A funny thing did happen to me, however, a year or two after that. The University was remodeling our office, and a four-drawer file cabinet of mine, an entire drawer of which contained notes from the preparedness

study, was put into storage. Somehow that file cabinet disappeared. No one at the University could ever figure out what had happened, and they were obviously mystified by the disappearance. But I think I know what happened. Don't you?

9

THE THIRD GUY IN LINE[1]

Between the end of 1929 and the first three months of 1933, over 6,800 American banks suspended payment.[2] Milton Friedman estimates that over 9,000 banks suspended payment.[3] Depositors lost over $1.3 billion, which in those years was a lot of money. But, in terms of the total assets in the banking system, these losses were small, under 60 cents per $100 in 1930 and 1932, about $1 per $100 in 1931, and $2.15 per $100 in the early months of 1933. However, if your bank went under, you lost everything. The "all or nothing" aspect of these losses emotionally scarred a generation of Americans. Those who saw their savings wiped out by a bank failure never forgot the experience.

Since the advent of Federally insured deposits, the number of bank failures has been minimal. The meager financial resources of the Federal Deposit Insurance Corp. have easily sustained the losses, precisely because nobody really believes that these financial resources constitute the real support for the banking system. Each account today, now that all banks are directly under the restraint and protection of the Federal Reserve System, is "covered" by about $1 per $100,[4] but few people worry much about this fact. Hardly a word appeared in the newspapers when Philadelphia's First Pennsyl-

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1. Published in *Remnant Review* (May 16, 1980) and updated in November 1982. As far as I know, this was the first analysis by anyone in the newsletter industry concerning the implications of "The Monetary Control Act of 1980," and its provision for using foreign government bonds as a legal reserve for the U.S. dollar.

2. Computed from tables in *Historical Statistics of the United States, Colonial Times to 1957,* published by the U.S. Department of Commerce (Washington, D.C.: Government Printing Office, 1960).

3. Milton Friedman and Anna J. Schwartz, *A Monetary History of the United States, 1867-1960* (Princeton, New Jersey: Princeton University Press for the National Bureau of Economic Research, 1963), p. 438.

4. These reserves are mostly government debt certificates.

vania Bank required an injection of $500 million in April, 1980. It had been predicted in the financial press for several weeks, and few people paid much attention.

That's the remarkable thing; nobody seemed to care. It's just "business as usual," something that can be easily brushed off. The two largest banks in Argentina have suspended payment [in the spring of 1980, two years before the Falkland's war], but how much news coverage did this receive? The world's banking system is threatened by an international recession, which places extensive strains on the Eurocurrency markets, yet hardly a paragraph is written on it in the conventional media [again, in 1980]. We are sailing in uncharted waters, and nobody appears to be bothered by the sketchy nature of our maps or the storm clouds on the horizon.

Brazil, which is tied with Mexico as the Western banks' most heavily indebted "Third World" nation ($67 + billion in late 1982, plus an additional $20 billion owed to various governments; Mexico owes "only" an additional $13 billion to governments), is so far in the hole that the government may have to borrow the money to pay the interest on its loans. ("Bankruptcy" in international lending circles is usually defined as a nation's inability to borrow enough money to pay only the interest owed on past loans.) In early 1980, the Brazilian government began to require rich citizens to loan the State 10% of "unearned" income above $82,000. They received 6% on their "loaned" money for two years, in a country which was at the time experiencing an inflation rate of over 80%. Even more startling, the law was retroactive; 1979's "unearned" income was taxed. If the money had already been spent, the taxpayer had to borrow the money that the government required him to "loan"—and nobody was lending money to private borrowers at anything close to 6%. This is the price which the Brazilian bureaucrats and politicians expect the wealthy classes to pay in order to help maintain the nation's international financial standing. And when Brazil can no longer borrow enough to pay the interest . . . ?

What happens in Brazil can affect the rest of the world. If Brazil defaults on the loans, the entire Western banking system would be threatened. Yet this is a real possibility. The international banking fraternity would have to cover up a default by making additional long-term, low-interest loans in some sort of debt roll-over.[5] Yet

5. This is precisely what Western banks did for Poland in late 1981 and early 1982, and for Mexico in the summer of 1982.

this only delays the day of reckoning. The money used to finance Brazil's long-term loans is very, very short-term money. Some of it is Arab money, and it can be called in overnight. Of course, how can it be called in? It can't, if everyone wants his money at the same time.

Therein lies a tale—a tale of lies. It is the tale of every fractional reserve banking system in the history of man. The bankers promise to redeem money virtually on demand, yet everyone knows this cannot be done if all depositors demand payment simultaneously, unless the banker has the ability to print up the money (or borrow from some agency which does). Everyone knows the system is based on a lie, yet everyone continues to play along. "Why not?" ask potential debtors. "It's the only game in town."

The bank run is an ancient expression of disbelief and loss of faith. The depositors finally come to the conclusion that the game is about to end. It's not that they one day become convinced that the system is fraudulent. They know from the start that you can't get something for nothing, that you can't receive interest payments from savings accounts that are not loaned out. But because of the nature of the universal lie—payment guaranteed upon demand—the system becomes vulnerable. When a majority of depositors become convinced that a majority of depositors have become convinced that a majority of depositors are going to try to get their money out simultaneously, a majority of depositors start trying to get their money out simultaneously. The lie is exposed for all to see. The bank is ruptured, or as we call it, bankrupt.

Number Three

Disregarding for a moment that it is a Federal crime to start rumors about a particular bank's insolvency if the intent is to start a bank run, consider the psychology of a bank run. We are never sure exactly what convinces a crowd to take action. Like the long lines in front of gas stations that appear overnight, the lines in front of banks can begin overnight, especially in a period of concern over economic developments. We simply do not understand what sparks a community's fears about local banks. We do know this: once aroused, these fears tend to spread like wildfire.

What keeps these fears contained today? First, as Friedman has argued, the very existence of a government promise to bail out the banking system has been sufficient to make such a bail-out unnecessary. Even if the promise is a lie, it is believed. So there is not

much incentive in spreading rumors about a bank's insolvency. We all know that the FDIC will intervene and back up the bank. (But all banks simultaneously?)

Second, we tend to avoid making outlandish statements. We don't want to be shown up as fools in retrospect. We want to appear normal, not fear-mongers. Besides, the bank might sue us. (I remember back in 1974 when Vern Myers warned in his newsletter about the impending crisis at the Franklin National Bank. The bank threatened a lawsuit, Vern apologized in print, and a few weeks later the bank went bust.)

Even if there were no government deposit insurance program, there would still be a third possibility: fear of being correct. Say, for example, that you're a finance minister for an oil-exporting Middle East nation. Your nation's financial reserves are tied up in the Eurocurrency markets. You know the banks have loaned out your money to Brazil, or some other Third World nation (probably dozens of them, all less productive than Brazil). You have been told that you can withdraw your funds on demand. You know the paper currencies of the world are all in rapid decline. You want your money, but the banks owe you too much. You can't pull out your money in cash—there isn't any cash in the Eurocurrency markets. You can only have your account transferred. Transferred to where?

There is one ominous possibility: *you can buy goods from the West.* You can get delivery of the goods, leaving the sellers with your near-cash assets. You can pass on the Old Maid (the dollar). You can make your "withdrawal" in the form of goods. Of course, you have a problem: keeping your fellow depositors from concluding the same thing at the same time. Otherwise, the prices of all goods will skyrocket. Everyone cannot get rid of the money at the same time. Every buyer needs a seller who is willing to take money in exchange. *We can't all be buyers simultaneously.* Were we all to attempt to become buyers of goods (sellers of dollars), dollar-denominated prices would become astronomical. The dollar's value would collapse on the international markets. The world's "reserve currency" would die. The disruption of world trade, not to mention world politics, would be the inescapable result of this collapse.

If you were trying to save your nation's capital (and save your own neck—literally—given the delicate and explosive political situation in the Middle East), what would you want to do? You would want to start transferring your assets quietly, without sounding the alarm.

You would start making *silent purchases:* ownership of foreign enterprises, American real estate, precious metals, high technology weapons, oil refining plants, and so forth. You would have to go slowly. You would not want to spread panic among the other OPEC finance ministers. If you acted too soon, you might be ridiculed, assuming nothing happened to the system. If you acted at the right moment, enabling your nation to get its money transferred to various nations for goods and services, but initiated the panic that might bring down the West's economy in a wave of inflation (and with it, your nation's minimal military protection from the West), you might face an assassination. No one in a position of leadership in a Middle Eastern so-called "non-aligned" nation, apart from the Ayatollah K, has wanted to destroy the West. After all, if you drive a Mercedes, you need spare parts. The Soviet Union is not going to supply them if the West collapses. (If the West collapses, the Soviet economy will collapse with it.)

Therefore, you don't want to be the man who starts a bank run that proves to be totally destructive of the very system which guarantees your continuing prosperity. You don't want the West to go bankrupt. You want to make the system work for you. You still remember your father's camels. You much prefer your Mercedes.

Yet you are in a bind. You know your peers across the sand also understand the nature of the deception. They also are worried about getting out while the getting is good. You don't want to trigger the collapse. Neither do they. You don't want to break the bank. Neither do they. But you also don't want to have your account frozen, or liquidated by means of mass inflation, when the bank is ruptured. Neither do they.

So you bide your time. You keep liquid. You buy very short-term finanical assets in major multinational banks. You remain ready to transfer your funds to some unsuspecting buyers of paper money or sellers of hard goods. You wait, and you watch. You watch for the first sign of panic. You are willing to let one other guy get his funds out, because you don't want to be the first guy in the line. It may be a false alarm, after all—nothing to worry about. You even wait for the second guy to get his money out, thereby confirming the trend. But you are determined to be the third in line.

Everyone is determined to be third in line.

This is why the Eurocurrency banking system is vulnerable. It is a pyramid of promises to pay money on demand—possibly a trillion-

dollar pyramid. Any one of these events could topple the pyramid: a Soviet invasion of Iran, the bankruptcy of two or three major European banks, a threat to the Straits of Hormuz and/or the Gulf of Aden, an escalation of hostilities between the U.S.S.R. and the West, a revolution against the Saud family in Saudi Arabia, the nuking of an Arab state by Israel.

The Europeans do not have a bank insurance system comparable to our FDIC, and certainly not for foreign banks operating in a particular nation. The threat of massive withdrawals is, to some degree, mitigated by the fact that the money is normally redeposited in another European bank or American branch bank. But if one or two key banks are faced with withdrawals that they cannot cover (being loaned out "long" to some Third World country), then domestic depositors—"nationals"—may also try to get their funds out. A few major bank failures, and the nationals may stream in to pull out their currencies from the banks. As a Middle East multimillionaire, or government official, you don't demand paper dollars from Eurobanks, but nationals can demand paper marks, francs, or whatever. *At that point, a deflationary collapse is conceivable.* It will then be in the hands of European central banks: Will they create the currency to meet the demand for cash withdrawals? In the past, they haven't.

Toppling Pyramids

I have always been in the camp of the inflationists—those who predict inflation rather than deflation.[6] I have consistently argued that the government can and will inflate the economy in order to save the economy from depression and the banks from ruin. But I have also consistently inserted this warning: the Eurocurrency market is only 20 years old, and nobody really understands how it operates. What it will do in an international recession is an unknown factor for all economic forecasters. My belief is that the system will

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6. Ideologically, I prefer deflation: no more government-guaranteed bank insurance, the abolition of fractional reserve banking, and the reduction of all government debt to zero. This program must be coupled to the abolition of all government-enforced price floors, the repeal of the Wagner Act (compulsory unionism), a vast reduction in the regulatory system, a cut in income taxes to under 10% at the Federal level, the abolition of property taxes locally, and a reduction of tariffs. This, of course, is only the beginning. If controls were left on, monetary deflation would create horrendous unemployment. In short, freedom is a package deal.

hold,[7] that not enough OPEC ministers will claw their way into the number-three spot (or attempt to), and that if they do, the national central banks will suspend withdrawals. However, they would then face an oil embargo, so they might be willing to break with tradition and create sufficient money to enable the banks to honor their commitments. But the system would have to be threatened mightily for the Europeans to intervene in this manner. Between the beginning of a crisis and an inflationary response, there could be several major bank failures in Europe.

The shakiness of the international monetary system was certainly implicit in the 1980 testimony of Dr. Henry Wallich, a member of the Board of Governors of the Federal Reserve System. He argued in favor of increasing the United States' monetary quota in the International Monetary Fund (IMF), which he said is necessary to undergird the organization's strength.[8] (The IMF's reserves, compared to the hundreds of billions loaned out through the Eurocurrency markets, is really insignificant. It would be hard-pressed to raise $20 billion in a hurry.)

Let me bounce this one off you. Here, I must admit, my instinctive paranoia may be in view, but I worry when changes are ratified by Congress that affect the nation's monetary system. Public Law 96-221, "Depository Institutions Deregulation and Monetary Control Act of 1980" (March 21, 1980), which was voted for by the House of Representatives, 380 to 13, made this very interesting change in what constitutes a legal reserve for the U.S. money supply. The FED's Open Market Committee, which buys and sells securities, thereby inflating (buying securities) or deflating (selling securities) the money supply, is no longer limited by law to the purchase of U.S. government securities. Since June 1, 1981, it has been legally able to buy the securities listed inside the brackets:

> . . . bills, notes, revenue bonds, and warrants with a maturity date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, country, district, political subdivision, or municipality in the continental United States, including irrigation, drainage and reclamation districts, [and obligations of, or fully guaranteed as to principal and interest by, a foreign government or agency thereof,] . . .

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7. Written in 1980; I still think so in late 1982.
8. *Federal Reserve Bulletin* (April, 1980).

Did you get that? The law of the land, as of June, 1981, has allowed the Federal Reserve System to go into the world currency markets and buy the bonds and notes of such nations as Zaire, Nicaragua, and any of 140 other possible sovereign states. Admittedly, the FED probably won't buy the debt certificates of all of them, but in a pinch—a pinch being defined as any threat to the solvency of the major U.S. banks involved in international finance—the FED can legally inflate our money supply by purchasing the notes of about-to-default nations. [If you want to verify all this, see the Federal Reserve Act, Section 16(3), as amended by PL 96-221, Section 105(2).]

Don't bother to write your congressman about this; he already voted for it, if he was a congressman in 1980.

You didn't read about this in your local newspaper? You missed this in your *Wall Street Journal*? All you read was that this terrific new law allows the government to phase out Regulation Q, one-half of one percent per year over six years, allowing the small saver to get more interest for his savings? That's all you were supposed to read. That's all the reporters got in their official press release handouts, and that's all they bothered to report. That's why people read newsletters; it takes several full-time paranoids like myself to dig into the maze of gobbledygook and ferret out the economic land mines.

This law has a lot of land mines. The reasoning of the government is as follows. When a domestic bank begins to topple, the public wants cash on demand. You can always write a check, getting your money into another bank, but you aren't sure the bank will still be solvent and honor your check. So people want cash.

If you are wondering about your bank's solvency, you might want to order a copy of a report on the financial condition of the 50 largest banks and the 50 largest Savings & Loan associations. It is published by Mark Skousen, "Special Alert: Problem Bank List" ($5). Order from

Mark Skousen
P. O. Box 611
Merrifield, VA 22116

Skousen bases his findings on the services of a unique organization which monitors all the nation's banks and S&L's. If you are wondering about the solvency of a particular bank, the firm will sell you its assessment. Send a self-addressed, stamped envelope and a check

for $25, along with the name of the institution you are interested in, to

Veribanc
P. O. Box 2963
Woburn, MA 01888

Obviously, there isn't that much cash lying around in bank vaults. The banks have the funds loaned out. So how does the government see to it that it has sufficient cash on hand to keep the banks open in a crisis—open banks being necessary to delay the spread of a panic? Simple; the government stores the money, by the billions, in the vaults of the regional Federal Reserve Banks. In the past, the requirement that the cash be collateralized when shipped to the regional banks tied the hands of the FED, since money in the vaults left a record. This might have called attention to a looming crisis, thereby triggering it. The new law has untied their hands. The language is quite specific:

> Collateral shall not be required for Federal Reserve notes which are held in the vaults of Federal Reserve Banks [Sect. 105(6) amends Fed. Res. Act Sect. 16(2)].

The cash can therefore be held in reserve without calling attention to the program of having cash on hand to quell a panic run on the banks. Only when it is needed to pour into the economy will it have to be collateralized (with Peruvian bonds, if necessary).

Apparently, Sen. Proxmire doesn't think this goes far enough. In 1980, he introduced Senate Bill S. 2305, which would have made possible the warehousing of "half a dollar bills," so that in a crunch, the Bureau of Engraving and Printing could crank them out on less critical presses. This bill reads:

> However, notwithstanding this provision or any other provision of the law, the back side of United States paper money of the denomination of $1 is authorized to be printed by a method other than the intaglio process, as may be directed by the Secretary of the Treasury: Provided, That the front side of such paper money shall be printed using the intaglio process.

Sen. Proxmire may well have some other reason for calling for a change in the law like this. Maybe it's to save money in the printing up of decreasingly valuable $1 bills. No use spending more to print

them than they are worth in exchange! But in the context of today's fears over bank failures, it is easy to see how this law, if passed, could provide the FED with piles of cash in a shorter period of time. True, these are $1 bills, but the sight of buckets of cash being passed from the vault of a bank to the tellers' windows is a great calming factor. Who knows that most of the bills are $1 notes? (Remember the old Westerns, where the gambler had a wad of bills—all ones, except for the hundred at each end of the wad?)

In any case, the new Monetary Control Act of 1980 allows the FED to stockpile currency in its regional vaults. In an emergency, the cash can be distributed rapidly, while the Open Market Committee simultaneously buys reclamation district bonds, or bankers' acceptances, or Cambodian bonds, or whatever Section 14(3) of the Federal Reserve Act now permits. The stockpile doesn't require any collateral until it is distributed, so the FED can sit tight and refrain from buying securities (which would be visibly inflationary) until panic runs on the banks begin. This law makes this strategy legal.

But even this may prove insufficient to quell the panic. So the law extends to all national banks the "protection" of a *bank holiday.* Or even more than one:

> Sec. 705(2)(b)(1). In the event of a natural calamity, riot, insurrection, war, or other emergency conditions occurring in any State whether caused by acts of nature or of man, the Comptroller of the Currency may designate by proclamation any day a legal holiday for the national banking associations located in that State. In the event that the emergency conditions affect only part of a State, the Comptroller of the Currency may designate the part so affected and may proclaim a legal holiday for the national banking associations located in that affected part.

Bank holidays—state by state, region by region—can be imposed at the discretion of the Comptroller of the Currency. Also, the law gives this same power to "a state or a state official authorized by law" to declare a holiday, on his own, and this holiday will then apply to "all national banking associations chartered to do business within the State unless the Comptroller of the Currency shall by written order permit all national banking associations located in that State to remain open."

Section 103(2)(d)(3) of this banking law permits *the suspension of all reserve requirements* if five members of the FED so vote. This emergency alteration of reserve requirements can go on for 180

days, "and for further periods not exceeding 180 days each by affirmative action by at least 5 members of the Board in each instance." The Board is instructed to notify Congress of the decision and to provide written justification. The wording does not say "zero reserves"; it says simply that "reserve requirements outside the limitations as to ratios and as to types of liabilities prescribed by paragraph (2). . . ." Paragraph 2 imposes 3% to 14% reserve requirements, depending on the size of the bank and the type of account. But the law permits a zero reserve figure. Obviously, the FED has been lowering reserve requirements, not raising them. If the range of reserve requirements is "outside the limitations," we can expect lower reserve requirements. The inflationary potential here is obvious. The fractional reserve process increases the size of the money supply from a given reserve base when reserve requirements are lowered.

Predictably, all "depository institutions" are now granted access to the FED's discount window, so they can all gain access to funds in an emergency [Sect. 103(7)]. This means that everyone's paper money deposits are "protected by law." Hurray for paper money.

Bank Runs in the 1980s[9]

I do not think that the standard bank run is likely to take place often in the 1980s. There may be a few, but the process will be stopped. Perhaps a bank holiday will be declared. More probably, the FED will simply print up the money necessary to calm people's fears of insolvency, meaning nominal insolvency (no more paper money fears). Runs could happen, and everyone ought to have a month or two of normal operating expenses in small bills ($20 or smaller) in reserve, just in case. This money can be "rotated" by buying cash items, and then replacing it by means of inconspicuous withdrawals from one or more bank accounts in several banks.[10]

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9. Added October, 1982.

10. Large-denomination bills, especially the $100 bill, are suspect. Congressman Schultze introduced H.R. 7283 on Oct. 1, 1982, which would force the government to retire all existing $100 bills and substitute a new $100 bill. This would presumably "flush out" cash used in the underground economy. Holders would have only 10 days to exchange them for new bills before the old bills lost their legal tender status. Anyone exchanging more than $5,000 (50 bills) would have his name, address, and Social Security number recorded and forwarded to the Department of the Treasury—assuming anyone was so stupid as to cash his bills in at one bank. Criminals and underground economists are usually a lot smarter than congressmen

The old insularity of the world markets was always somewhat mythical, as the Great Depression proved. But with the rise of electronic funds transfers, floating exchange rates, and the dollar as a reserve currency, the ability of banks to expand the money supply for international transactions was greatly enhanced.[11]

Let's look at the Eurodollar market for a moment. What if Saudi Arabia gets angry with U.S. foreign policy in the Middle East? The Saudi government starts calling in its loans to New York banks. Will the system crumble?

We have visions of bank runs in 1933. But bank runs are runs into *cash.* What will the Saudis do, go down to Chase Manhattan or Citibank and get the Brinks vans to line up and pull out a few billion in cash? And even if they do, what will they do with the cash? Obviously, they will invest it. And what will the investment house do with the cash? Deposit it. So the system has some built-in stabilizing factors.

But the fact is, they won't ask for cash. They will blip their money to another Eurobank. All of a sudden, that bank will face a problem: Where to invest this new money to pay the Saudis the London interbank rate for the day? Well, who is in need of a few billion extra? Obviously, the New York bank that just had its money pulled out. So the Eurobank agrees to reloan the money to the American bank, at a rate of half a point higher. Presto: the New York bank is back in business, although not so profitably. It was this arrangement that would have been imposed in November of 1979, when President Carter froze the Iranian accounts. Had he allowed them to pull the money, Chase Manhattan Bank and others would have reborrowed it. You cannot lock up money in one nation any more unless you want to stop all trade, growth, and prosperity. It can be done, but the price is very high: the end of economic growth.

So a run on an international bank is very hard today. Or let me put it this way: the *traditional* run on the bank is very hard. You know, the kind of bank run where people start lining up to get their money out. You can see the picture in your mind: a gray day in

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who introduce bills like this one. But the bill is a sign of the times. It may eventually pass, or something like it. Or it may just be declared under an Executive Order.

11. Jacob S. Dreyer, Gottfried Haberler, and Thomas D. Willett (eds.), *The International Monetary System: A Time of Turbulence* (Washington, D. C.: American Enterprise Institute for Public Policy Research, 1982).

Kansas in 1933 when people ran to the bank to "cash out." What happened? The teller finally slammed the window shut, and announced to everyone who had arrived too late, "Sorry, folks, the bank is busted." We all have seen it in the movies. It was the kind of thing that made John Garfield start robbing banks.

Well, it's still going on today. Only our world is different. People are not worried about deflation and broken banks. Yes, a few people talk about it, and they buy trial subscriptions to newsletters to find out all about it, but they don't act in terms of it. (The appropriate strategy: 5,000 $1 bills hidden in plastic, waterproof tubes and buried in the back yard.) People don't move into smaller homes, sell the large one, and pay cash for the new one in the less desirable neighborhood. They don't sell their homes and rent.[12] They talk about deflationary depression; they don't act in terms of it.

The bank run today is huge. It's not understood for what it is. But let's see it for what it is. People aren't worried that the teller's going to slam the window shut. But all over the world, for almost a decade, people have made runs on banks. They don't go to the teller's window; they go to the *loan officer's* window. They are afraid that the inflation process, week by week, will destroy their position financially. They want to "buy now, pay later," and they see that everything will cost more if they wait.

In 1973, the Arab oil embargo began a revolutionary process, or at least vastly accelerated it. Billions of dollars poured into tiny, underdeveloped Islamic nations. What to do with this money? Put it in the bank. So they did. A tidal wave of money poured into a handful of large multinational banks in New York City and the City (the banking section of London). Now the bankers had a problem: What to do with the money? They had too much money to handle, and it came too fast. They didn't have time to plan a hundred thousand little deals. They didn't have the manpower. So what did they do? Just what you would expect: they started looking for sure-thing, guaranteed-return investments—multi-billion dollar investments. What organizations could absorb such money? Multinational corporations, agribusiness firms, and governments. Mostly governments. They can absorb all the money even New York bankers can

12. Actually, one man I know did, a former senior official with the Bank of Hawaii. He sold his home and started renting in 1979, since he was convinced that the wild speculative real estate bubble in Hawaii was going to burst. He was correct; it did.

throw at them. What to do with today's thirty million? "I know, I know: let's loan it to Peru!" So they did.

They were geniuses at making loans. Geniuses! Unfortunately, they aren't so smart about collecting payments. So Mexico says that bankers will have to restructure its loan obligations. "Restructure" is a lovely word. That means "lenders must take a bath financially." Except it really doesn't. It means that the market value of the loans will fall, but banks play the "book-value" game. What is the loan worth? The multinational banker answers: why, just what it says on the note – $80 billion, payable in dollars, at 8%, for 30 years. Sure. Just the way all those low-interest mortgage loans in the savings and loan institutions, or in some officially "off-budget" U.S. government agency's "portfolio," are worth face value. Warning: don't try to unload them at a market price. The book-value game would then end.[13]

I do think we will see bank runs. I think we are seeing them today. Unlike the bank runs of the 1930s, in which depositors made "raids" on the tellers' windows, demanding cash, these runs are being made by borrowers who are making raids on the bank lending windows.

Consider Mexico. In the summer of 1982, the Mexican government defaulted on at least $80 billion in debts to the West. Now, this was not called a default. It was a "temporary cessation of payments" and a request for a "restructuring of the loans." In short, allow us to stretch out repayment for as long as we want, and at a low rate of interest, or we will default officially. Poland played the same game with Western banks in late 1981. Argentina may follow suit. Some competent private researchers have estimated that about $500 billion in weak or bad debts are owed to Western banks by Third World nations – debts that cannot be repaid with money of today's "high" purchasing power.

What really happened? The Mexicans had made a run on the West's banks, based on collateral of the government's hoped-for oil

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13. The reason why savings & loan associations were hesitant to offer discounts for cash to anyone who would pay off older, low-interest loans when new loan rates hit 17% in 1981-82 is simple. The lending institution would have shown a loss: book value to the discounted cash now in its vaults. It had already sustained the loss, economically speaking, but the thrift industry regulators allow the assets to stay on the books at the original face value. The institutions needed the cash, but their officers did not want to admit for the record what had happened to the market value of their portfolios. You can hardly blame them; bad loans (loans paid off at a discount) bring in examiners from various Federal agencies.

revenues at OPEC's hoped-for prices. Mexico's government and its huge, bureaucratic, State-regulated corporations borrowed heavily throughout the 1970s, especially after 1976.[14] They "got while the getting was good." After running up a huge bill, they defaulted. They used the money to buy up Western goods and services, and now they have the goods and the West has the IOU's.

Nobody has publicly identified this process as a bank run, but that's what it is. The debtors buy up the goods while the money is still relatively valuable; then they "reschedule." This is not what most private borrowers are doing, but huge international organizations are, mainly national governments. The banks have loaned out so much money to the Third World that they don't dare risk a public, official default. They can keep the loans on their account books at book value, until the day that the borrower officially defaults. *The "game of games" today is to forestall the legal impact of an official default, so that the game can go on.* This is true of savings and loan companies, too. They are afraid to repossess homes, for fear the loans will be identified as bad loans by the examiners.

The purchasing power of the dollar is headed downward, in the same direction as the true market value of those fine-looking book values in the international lending sections of the multinational banks. The Monetary Control Act of 1980 will enable the FED to bail out those insolvent debtors in order to keep the book value of the loans at "full" book value. Meanwhile, the purchasing power of our money will head for the cellar. The purchasing power of the dollar may very well make the *book* value of the loans equal the market value of the loans, i.e., *zero*.

Well, what debtor—and this means just about everyone—can blame Mexico? The bankers made it look so easy! It *was* easy. But then the oil revenues fell, and the real market value of the peso fell, and the debts grew too large to "service." The government had to end the "book-value" game of the peso, namely, the high fixed exchange rate—government price control—between the peso and the dollar. It was a government-manipulated fiction, and the rush out of pesos and into dollars in the first half of 1982 called the government's bluff. It dried up the available supply of dollars at the phony, below-market price. The government, itself in hock to the Western

14. Something in the range of 60% of the large industries in Mexico were owned by the government before the nationalization of the banks. Now the government owns 37% of the remaining 40%.

banks, could no longer supply enough dollars to private buyers (sellers of pesos). Another price control bit the dust. The collapse of the peso has been disastrous for Mexico's future: the Mexican middle class is being wiped out by inflation, and a revolution of rising expectations has been thwarted—the classic environment for a political revolution. But the government had no choice; market forces broke the fiction of the 4 cent peso. (But this did not necessitate the nationalization of the remaining privately owned banks and the confiscation of all dollar-denominated deposits in those banks.)

Besides, Mexico was really a latecomer to the bank run swindle. Zaire learned about bank runs a decade ago. Poland is good at it. Argentina is learning. Why, just about every debtor nation is getting the picture. It's the old rule:

> "I owe you $10,000; you've got me."
> "I owe you $10,000,000; I've got you."

This time, the bank run is being made by the debtors, not the depositors. Since most people think of bank runs in the 1933 version, they don't see what is taking place right under their noses. The great bank run is now in full swing. Because everyone knows that governments will inflate to keep the depositors from making a run on the vaults, they want to borrow money while it will still buy something. The purchasing power of fiat money drops steadily, universally, continually. People are catching on. Borrow a bundle, buy the goods, watch the price of the goods go up, and then (if you are a foreign government which is immune from foreclosure) default. The banks will then put together an "emergency loan package" to bail you out, so you can continue to make interest payments. Why are bankers so stupid? They aren't stupid; they're smart. They can keep playing the only game there is in international lending—not to mention Savings & Loan mortgage lending—*the book-value game.* If borrowers are paying interest, then the loans must be worth what it says on the notes. The banks remain legally, technically solvent.

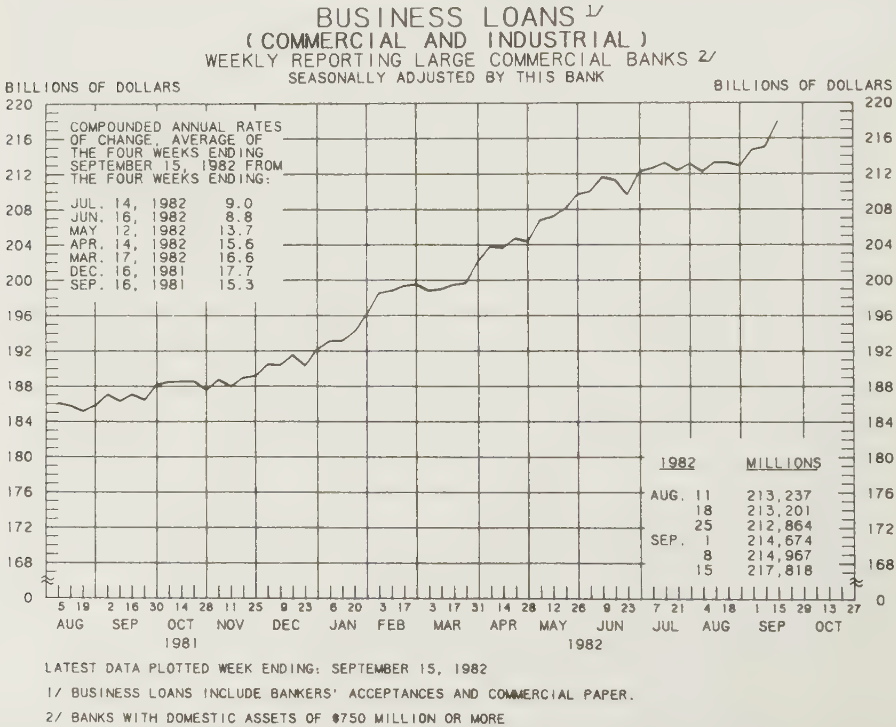
But the money isn't solvent.

You see what's happening? The big borrowers are buying up the goods. The big lenders are playing the book-value game. The little depositors are complacent. And the big government is committed to creating more fiat money. The little dollar is still shrinking.

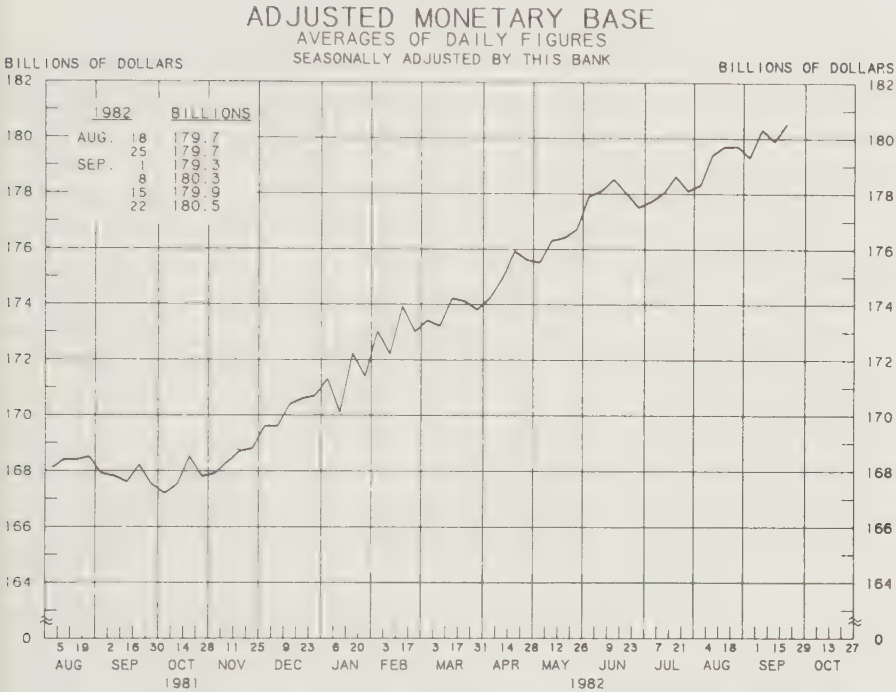
The bank run is taking place, not by the depositors, but by the debtors. It's taking place daily—not to the bank in the square but to

the rectangle in your wallet. The "bank" is anyone who holds cash, long-term credit instruments, and faith in the currency unit. The "bank" is the patriotic citizen who has faith in government promises. The people doing the run are the skeptics, especially governments, who are borrowing heavily in expectation of the bankruptcy of the currency units of the world, especially the dollar. They aren't worried about the teller closing the window; they're worried about the lending officer closing the window (mortgage money, for example). They worry about the sellers of goods and services not selling for paper money. The run on the bank today is the policy of monetary inflation.

We can see the "borrowers' bank run" on the graph: business loans. These loans began increasing in 1982, despite the recession.



Even in the midst of a recession, the figure for business loans kept rising. It had slowed until late in 1981. Now take a look at the adjusted monetary base graph. Look at the rate of increase. The two graphs are shaped similarly: flat through 1981 and then moving upward.



This is the bank run in action. The monetary authorities keep creating fiat money to keep the system going, and the debtors line up to borrow the funds. We are seeing the "bank"—the purchasing power of the currency—hard-pressed to stay afloat. We are seeing the breaking of the bank.

I know that you haven't read about this bank run before, but my analogy is pretty much to the point. Because people confuse deflationary scenarios with inflationary ones, they worry about the wrong events. They worry about the movie versions of the 1933 bank run, and they do not understand the one going on in their hip pockets. The Monetary Control Act of 1980 makes the bank run close to inevitable. The FED can buy up the debt certificates of foreign governments, using newly created fiat money, transfer the money to debtor governments, and then these governments can repay their loans to Western banks. Meanwhile, these foreign bonds are used as the legal reserve asset for the U.S. dollar. Well, why not? It's just another piece of paper. All we have done is to invite Argentina into our popular verbal game, "we owe it to ourselves." If the national debt is never going to be paid off anyway, who cares? Why not get

Argentina's promise to pay in depreciated money, since the money is not going to be paid anyway?

Planning for a "teller's window" bank run defends us against the great bank run of our memories, or our grandparents' memories; it does not protect us against the one presently going on. The debt game is a universal one today. It leads to disaster. When the bank is closed, when the currency unit is no longer trusted, what will we do then? We will do what they did in the 1930s: try to find a solvent bank. Gold will be one. So will silver. Here are banks that are fairly secure from the "bank run" of mass inflation.

If my analysis is correct, then the bank run will continue because few people recognize how the run is being pulled off—by debtors, not depositors, by foreign nations that default and borrow again.

We will eventually see closed windows. Not the teller's window, but the seller's. You may be able to get greenbacks, but what will they buy? When the run gets rolling, the line will get long. It will call attention to the nature of the run. Prices will skyrocket, supplies will dry up, and people will hoard goods.

I know, hard-money newsletters are always warning about this, but it never seems to come true. The reason why it doesn't is the tightrope walk of the Federal Reserve System. Each wild run-up of prices is worse than the last. We forget that 1967 prices were less than one-third of today's in the United States. Waves of price inflation are followed by recessions, a slowdown, and a psychological shift to fear of recession and unemployment. These psychological shifts prevent the panic blow-off that hard-money newsletters warn against. Without these shifts, there would be an accelerating "run on the bank," namely, massive indebtedness, immediate spending, and the disruption of markets.

The FED walked the tightrope between deflationary depression and mass inflation pretty well from early 1980 until late 1981. There were grumblings on the Left and Right, but no major move to loosen up money, as of the fall of 1981. Then the FED began to inflate. The skeptics took the cue. The rise in the price of gold in the summer of 1982 was accompanied by an increased response for newsletter advertising, indicating that the Reagan euphoria (1981) and the Reagan hope (1981-2) had turned into the Reagan hedging. We began to see money being put into market assets and information that lean toward skepticism. This skepticism is well-founded today.

The 1930s type of bank run is a minor threat. A mild inflation has kept it from occurring. The FED has relied on the myth of the Federal Deposit Insurance Corporation to keep this other sort of run from happening. People trust that $100,000 of insurance on their bank accounts. But the insurance against a teller-window run—the promise of more fiat money—is what is creating the lending-window run. The huge indebtedness of the modern world is literally self-perpetuating. The possibility of a toppling of the pyramid of credit—bankruptcies, inability to pay off obligations, liquidity crisis, falling prices—gets greater the larger the pyramid. But the run on the bank at the lending window keeps that debt pyramid expanding.

While 1982's 7% expansion of the monetary base may not sound like much, it will be after a few decades of the compounding process, even if it stays this low, which I do not expect. An expansion of the monetary base by the FED (through the purchase of debt certificates) eventually leads to a corresponding rate of increase in the money supply. But the money supply is so high, and prices so ratcheted, that the tightrope walk is a lot more dangerous. The rope is always headed upward. There is no economic safety net; what we perceive as a safety net —for example, FDIC insurance—is nothing more than another, higher tightrope. Once on it, you can't get off. You can only climb higher.

Interest rates fell in 1982, as a result of tight money. The inflationary panic no longer was driving consumers to the lender's window so powerfully. But as rates dropped, business loans increased. They are rising rather significantly once again. This is what I'm talking about: climbing higher on the tightrope. It's a rekindling of the bank run against the dollar. The recession ends slowly—more slowly than conventional investment advisors, including the President's advisors, ever said. But borrowers are locking in their positions in front of the lender's window. It's like the 3 a.m. line in front of the country bank in 1933. Most people don't see it yet; they're at home in bed, dreaming of better days. But the line is forming.

"Good" Bank Runs

There is a tendency during a recession to view an increase of business borrowing as a sign of returning confidence in the economy. This is why today's bank run is not viewed with alarm, the way a similar run was viewed in 1979. It's now a great thing that the banks have lines in front of the lending windows. After all, isn't investment necessary to "get the economy rolling again"? Why worry about a

rekindling of the debt mania? We need a "shot in the arm."

The FED is being cautious. It is accommodating the bank run only mildly. The 7% increase in the monetary base in late 1982 was not sufficient to create panic. But the preliminary stages of a lending window bank run is visible in the graph. It is being interpreted as a preliminary phase of a new bull market. It probably is. But the bull market, once begun, is a wild phenomenon to direct.

How will it be controlled? One way is with credit controls. I think we could have a round of credit controls before the Reagan Administration has ended. The central bank, under Congress' somewhat erratic oversight, will be empowered to fund "good" projects. The bank run of debtors will be channeled into government-approved projects. But in a world of electronic banking, it is virtually impossible to run a tight ship in the credit markets. The pipes start springing leaks. Money seeks out its highest return, and at a price, the credit controls can be short-circuited. Bankers know this; politicians don't. In 1978, American businesses borrowed about $5 billion from the Eurodollar market. By 1982, the amount was about $40 billion. Credit controls are difficult to impose without total controls.

Businessmen who are indebting their businesses today are, whether consciously or not, hedging themselves against credit controls. They are tapping lines of credit. The bank run has to begin with someone. It's true that when you "stand in line" you forfeit the money you might have earned elsewhere. When you take a debt before the run begins, you are paying interest on a loan that you might have been able to do without. But you have secured your place in the line in front of the lending window. People are paying for this privilege today—a growing number of people.

I listened to an interview with a Savings & Loan expert in the fall of 1982. He predicted 12% mortgage money, possibly in February of 1983. He thought that newly approved money-market-type of accounts that pay higher interest rates will lure money back into housing. "Get a variable rate mortgage," he said. "You can buy a home at today's depressed prices, and then get a reduction in your mortgage payments next year." True enough, but only temporarily. The boom in housing prices when mortgage rates finally fall will be the event that will lock millions of people out of the housing markets, possibly permanently. Home buyers and prospective home buyers will make a "raid" on the lenders' windows all over the country. But if this takes

place, then mortgage rates will again rise; these rising mortgage rates that are the product of high demand for loans will put the squeeze on homeowners.[15] They will do whatever is necessary to stay in their homes. There will be crises down the road when people have to sell but won't be able to. Then a freeze on interest rates will become politically popular. Frozen interest rates are, of course, a form of price control. Price controls on interest rates will dry up the supply of privately funded mortgages. At that point—the late 1980s, I would guess, though possibly sooner—separate unit, single-family housing markets will be closed to new, first-time home buyers, except for government-subsidized construction and lending.

You see, every bank has its limits. The dollar's purchasing power eventually will fall so much that people will not sell homes any more. They may trade them, but they will not sell for cash. They will be too fearful of selling on long-term "owner financing." Then liquidity dries up. You may want to buy, but sellers won't want to sell. This is the equivalent of the "shut window" in 1933. The bank goes bankrupt. The lending-window finally breaks the bank. Nobody wants to sell people hard goods for the worthless money being lent at the window.

This situation exists today in Italy, France, and most other European nations. In the summer of 1982, according to one real estate specialist I spoke with, a 3-bedroom house in northern Italy cost $100,000—not lire, dollars—cash, and even then there were very few sellers. Rich people in Italy are actually building houses for young family members and then boarding up these houses for 10 years or more, so that renters—who are favored by the government with permanent access to rental units—cannot get into them. Farm land was selling for $30,000 an acre, cash. Present owners are unwilling to give up ownership of what they regard as a family heritage for mere paper money. Warning: if the United States pursues the same monetary and legislated social policies, similar situations will develop here. It took less than two decades in Italy; it need not take this long in the United States. We have had too many years of inflation already; people are catching on to the way the inflationary world works.

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15. I do not recommend variable-rate mortgages. Pay a higher rate of interest if you must, but get fixed-rate loans. Anything else is too risky. If rates go down and stay down, then refinance your home at a lower rate. But best of all, try to pay it off early.

What the lending experts are telling us is that they expect a renewed boom. But the ratchet effect is still with us. Interest rates don't go down to the levels of 1976; neither do prices. The last recession's level of prices is always significantly lower than the latest recession's effect on prices and interest rates. Each boom—bank run—takes off from a higher plateau.

So there will be a new bull run. The run on the "bank"—the dollar's purchasing power—will resume. What should be your strategy of evasion? *Get your money out of the "bank"*—the preinflation markets—*by getting rid of the money.* Get dollars now, spend them before they drop in value, and leave the other guy with a fistful of dollars. In an emergency, do it with debt. This is the modern version of the bank run. It presumes that there will always be a guy stupid enough to get stuck with the old maid, paper money. *Eventually, there will be no easily available suckers; people will learn not to trust the paper money. You need to act before this happens.*

The line isn't very long today. It is still 3 a.m. Nobody is paying much attention to inflation. The "run"—the rekindling of the economic boom through buying on credit—is even heralded as a positive sign. It is positive in the sense that a man on a tightrope senses a disaster when he begins to lean too far on one side. He will do anything to right himself, including jerking so hard in the other direction that he starts to topple in the other direction. This is where we are today. The FED's policy in 1982 was to try to keep from lurching over into deflation, but without blowing the lid off. So far, so good. In 1982. But not after 1982.

I became mildly bullish on the economy and the precious metals in June of 1982, at the bottom of the market. I still favor what I wrote then. I think people should be steadily getting out of T-bills, month by month, and into the precious metals. But liquidity is still important. The lurching of the economy may not be over. The FED indicated in 1982 that it was not yet ready to uncork the money supply. The economy is hardly on a true stabilization course; it is barely recovering from a major recession. That recession is over, but the effects psychologically will linger on. The public will continue to be hypnotized by the unemployment figures, which are always the last figures to return to "normal." To get the economy "off and running," the FED will have to pour in the money.

Businessmen are beginning to expand business operations slowly. The demand for business loans has turned upward. It is not a

"lender's window bank run" yet, but the rising demand for bank loans in 1982 indicates what businessmen think lies ahead: a rekindling of the boom. This always means monetary inflation leading to price inflation. Borrowers may not understand how this type of bank run operates, but they are getting in line anyway.

Insurance Company Woes

Life insurance companies tell us what has happened. People are borrowing heavily at below-market rates by borrowing against their policies' cash values. The firms know that they won't get this money back. They are "lent long"—they have bought bonds with the money—and "borrowed short." Their policy-holders are putting the squeeze on them. They have to sell off bonds and mortgages at a discount to come up with the funds to make the loans. A tremendous cash squeeze has hit some of them. This, in my view, is why the industry finally adopted new mortality tables. They had to have a way to get premiums low enough to begin selling policies ("borrowing short") from new clients. They can't sell whole life insurance easily any more. In other words, they are running short of "depositors" (policy buyers) and facing a bank run (borrowers). Because they can't create money, unlike the FED and the banks, they are trapped in a way that banks aren't. They aren't Federally insured. The higher interest rates go, the more they will be under pressure.

(The wise reader will take advantage of this situation while he can. Immediately check with an independent insurance agent and find out if he can offer you a cheaper annual renewable term policy. Your present company probably will not alert you to the existence of new policies based on the 1980 mortality table. See the Appendix on suppliers for the names and addresses of independent agents who sell very inexpensive term policies.)

We are running short of long-term lenders. The windows are closing in the long-term credit markets. That's the sign that the crisis is looming. People are losing faith in the solvency of the "bank" (the dollar). They won't make deposits here forever. The goal is liquidity: the ability to get out of dollars fast. Only there is a built-in limit here: everyone can't get out of dollars simultaneously.

The line is forming. Better get in line. You had better have your money spent, and the goods in your possession, before the wild run takes place.

Conclusion

Congressman Ron Paul of Houston led the fight against H.R. 4986, which eventually became PL 96-221. He has continued to alert people on his mailing list about developments in the banking field, and I would encourage you to contact his office and ask to be put on his list. Write: Cong. Ron Paul, House Office Bldg., Washington, D. C. 20515.

What Dr. Paul and his staff believe is that this banking law, "Depository Institutions Deregulation and Monetary Control Act of 1980," creates the mechanism to overcome the threat of bank failures, but only at the expense of the dollar. The banks will be saved, but the cost will be astronomical. As his executive assistant said, "They will conquer double-digit inflation with triple-digit inflation."

While I was not in the trenches on a congressional staff to try to slow down the passage of this law, I nevertheless concur with the judgment expressed by Congressman Paul. I think the bail-outs will be as smooth and quiet as the bail-out of the First Pennsylvania Bank. You may not even read anything about it in the newspapers. At each step of a potential panic, the government has now placed a banana peel, to trip up the panic-mongers. But those peels, if found necessary, can be effective only at the expense of the war on inflation. The government has been careful to build in some key defenses against bank runs, but the result should be obvious: mass inflation.

The third guy in line will get his money. A bank holiday is likely to be temporary. The bank may never close. But the guy had better know what to do with his money. He had better not be satisfied with having cashed out his account. The line in front of the bank is just the first of several critical lines you will want to stand in. You need to be the first guy in line in the others, one by one. A bank panic will probably lead to a money panic: mass inflation. And then will come price controls.

You need a comprehensive financial strategy if you are to deal with controls. Part of it should begin immediately. Part of it can wait. But you need to have its rough outline in your mind from this time on. Most Americans won't know what hit them. They barely understand what has already hit them. You know, if you have read this much of *Government By Emergency.* It is time to begin sketching a defensive strategy.

PART III

ESCAPING WASHINGTON'S SOLUTIONS

10

A LEGAL FORM OF TAX REBELLION[1]

Inflation is a tax. This statement has become almost a truism within hard-money circles. Yet it would seem that no matter how many times we repeat this phrase to ourselves, we are unable to face its implications squarely. There is some underlying psychological barrier that persists in spite of rational attempts to overcome it. *We continue to view our inflation-hedging activities as just another form of profit-making activity.* True enough, there are entrepreneurial profits involved in successful hedging, since the successful hedger (used in the non-technical sense of speculator) has successfully forecasted the future and has taken efficient action to deal with it. But in the final stages of runaway inflation, a fundamental shift in perspective takes place. It involves successive panic movements out of cash or cash-related paper investments. It finally involves total distrust of the monetary unit. To quote the old Marxian formula, a quantitative change produces a qualitative change. At some necessarily undefined point, a majority of participants on the domestic economic markets adopt wholly new patterns of trade. The psychology shifts from making a profit denominated in legal tender currency to making a profit by *getting away from* legal tender currency.

What do we mean when we say that inflation is a tax? First, and most important, the expansion of the money supply allows those creating money to purchase goods and services at prices that reflect yesterday's supply and demand conditions, including yesterday's money supply. Those who possess the new money are able to buy

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1. I wrote the outline of this paper in about 30 minutes the night before I was scheduled to speak at Jim Blanchard's gold conference, held in New Orleans, in late fall, 1974. Someone with the staff of the National Taxpayers Union heard the speech and invited me to speak at the NTU national meeting on April 17, 1975, which was held in a small room—which proved to be way too big—at Georgetown University. About a dozen of us showed up. Since then, I have begun to draw larger crowds, and the NTU has become a lot more influential.

these goods before others get access to the money. Only as entrepreneurial forecasts by the public begin to take into account the likelihood of the new money coming into existence will the price level begin to respond more rapidly to the new monetary conditions, or even in advance of the creation of new money. In short, as long as the so-called "money illusion" operates, and men fail to foresee its impact on prices, those with the new money can redistribute productive goods and services into their own hands. When government has the monopoly of money creation, or when it has first access to any new money created by government-licensed central banking procedures, then government reaps the benefits initially. Hence, monetary inflation is a tax.

Only slightly less important is the invisibility of this form of taxation. Not one person in a thousand understands how this process works. (Before Harry Browne scored his publishing coup, *How You Can Profit from the Coming Devaluation* [1969], not one person in ten thousand understood it, which is why Harry deserves a lot of thanks.) It is too easy for the perpetrators of the redistribution — government politicians — to blame someone or something else: labor unions, businessmen, the weather, Arabs, anchovies, etc. The public is unable to respond correctly to the problem because it has not diagnosed it properly. Historically, it has only been the breakdown or near-breakdown of a nation's monetary unit which brings home the truth of the monetary source of the price inflation. A *Wall Street Journal* cartoon is all too typical: a housewife is complaining to her husband about the economy. "The real shortage is our shortage of money." That may be the problem for the individual, but on a national basis, the psychology of inflation can be broken only when the mechanism of inflation is broken: fiat money. But the cry for more money is as loud as the cry against those price increases that finally begin proportionately to outstrip the increases in the money supply, as people foresee each wave of new money and frantically enter all markets, thereby bidding up prices in advance. The wealth redistribution effects become too complex to follow; only those on fixed money incomes are sure losers.

What is the *theoretical limit* of price inflation? The point in time at which *no one will voluntarily give up any further scarce economic resources in exchange for government money.* Then private individuals revert to barter or to some unofficial alternative medium of exchange. The government is then compelled either to confiscate goods directly or else

reform the currency. The inflation tax has reached its theoretical limit.

Four Stages of Tax Rebellion

Colin Clark, the Australian economist, has studied the history of modern taxation very carefully. He found that in all known cases in which the government tax bite took more than 25% of national income, the governments resorted to the inflation of the money supply in order to accomplish their fiscal goals. Clark has been criticized by Keynesian inflationists for not providing a theoretical reason why this should be invariably true. Obviously, no such proof is possible. Academic Keynesians smugly conclude that Clark's 25% figure is therefore meaningless. It is not meaningless; it is a statement of historical fact, not theoretical inevitability. As a product of historical research, it demonstrates that statists have always encountered political resistance at and above the 25% figure, and they have always taken the same route in "solving" their problem. The smug Keynesians—smug before 1967, anyway—are incapable of showing any theoretical reason why the same old panacea will not be tried once again. It is an argument about comparative economic history, not economic theory, and Clark has all the historical evidence on his side.

The four stages of tax rebellion parallel the four stage of any inflation. They are not absolute categories; they are convenient classification devices that seem to fit fairly well in a number of historical cases, and may very well be found to fit what is coming in this country. Whether the fit is significant is yet to be seen.

Stage One: non-monetary strategies. These involve sophisticated tax shelter schemes, some completely legal (Keogh retirement plan, oil exploration, etc.) and others more questionable, i.e., risky (foreign tax havens, complicated corporate ownership, etc.). These latter avenues of escape are open to only a tiny handful of relatively wealthy people, since the information is difficult to obtain, and those who use them must stay very mobile (e.g., Robert Vesco).

There is also outright defiance. Some individuals just fail to declare portions of their income, especially cash income. This is the most widely used form of evasion. Others declare their ideological opposition to taxation, or some aspect of taxation, and refuse to pay. When the authorities think it is worth their time and effort to clobber the ideologues, they move in. The risks seem very high, and the non-

ideological nature of most people's tax evasion is such that few converts are gained. As long as people think the State is basically an honest institution, or as long as they think they can benefit personally from an obviously crooked State, the tax revolt is of the "let them catch me" variety. This sort of evasion is not that important fiscally. Most people pay taxes on most of what they earn, because most of the money is in the hands of middle class people who are only marginally involved in tax evasion. The tax rebellion has to convert too many people who neither understand the arguments for outright rebellion nor agree with most of them when they finally understand them. In any case, they are not going to take the necessary risks. The tax revolt, as a conscious ideological movement, does not stand a chance—in Stage One.

Stage Two: monetary strategies. When the State inflates in order to get beyond that general limit of resistance at 25%, more or less, of national income, then the public changes the rules. Men who are aware of what is happening to the purchasing power of money begin to hedge. They buy hard goods, sign long-term debt contracts, speculate in foreign currencies, and reduce their ownership of mortgages or bonds denominated in fixed monetary returns. These tax resistance groups are not organized. They are seldom even ideologically inclined, although the original source of their strategies may be very ideological (e.g., Harry Browne). They start taking action in their own businesses; they read about others who are attempting similar moves. These are tax evasion strategies; men are escaping the invisible tax of monetary inflation. But since the inflation tax is not seen as a tax (precisely the basis of its popularity with governments), men feel far less guilty about their involvement in this form of tax evasion. In fact, they pride themselves on their skills; after all, profit is a sign of one's intelligence and forecasting skills.

This kind of tax evasion is extremely relevant fiscally. As men increase their skills in hedging against inflation, it becomes even more relevant fiscally. The governments are unable to buy so many economic goods as before, since prices rise in anticipation of the increase in taxation, i.e., the increase in the money supply. Even worse, the State is unable to buy so many votes. Projects become insufficiently funded (rising prices) and voters lash out against rising prices, i.e., the inevitable effects of the inflation tax.

The most difficult aspect about this form of tax evasion, from the government's point of view, is that it is legal. Furthermore, it does

not create sufficient guilt in the minds of the successful evaders, thereby lessening the control the priests of statist salvation have over the public. This tax rebellion is basically unorganized, non-political, middle class, and self-sustaining: successful strategies of evasion are imitated. The tax men become desperate to close the avenues of evasion.

Stage Three: controls. In response to the cries against rising prices, the government makes rising prices illegal. This creates what Prof. Röpke called "repressed inflation"—the economy of shortages. Economic goods are rationed by various non-monetary-price means: power, coupons, long lines, sexual favors, barter, etc. Productivity is drastically lowered. But most important, from the point of view of the government, is that government bureaucrats once again gain first access to "money," whether the money is in the form of ration coupons, priority allocation licenses, food stamps, compulsion or whatever. Inflation-tax evasion is once again made illegal and guilt-producing. Hoarding becomes an immoral act against humanity rather than a rational response to the threat of confiscation by the State.

Those who feel guilty or fear the arm of the law refuse to participate on black markets, at least until they feel sufficiently squeezed financially to make profitable a *search for illicit goods* and the even more important *search for moral self-justification* for their search for illicit goods. Eventually, everyone who wishes to survive enters the black markets for at least a portion of his economic supplies, but those who were initially patriotic or fearful now pay for their personal qualms by having to start from scratch. They have less information, fewer hoarded supplies, and greater hesitancy than their fellow citizens who simply ignored the laws. Initially, there may be few evaders; eventually, the whole society participates. It becomes dangerous to advocate publicly those economic strategies that are economically obvious but officially illegal. Learn while you can. The night cometh.

Some Americans bought gold bullion long before it was legal for them to own gold bullion. They were willing to buy Austrian coronas or South African Krugerrands. Then the government legalized such ownership in 1974, making "fools in retrospect" out of many patriotic citizens. They had missed the bonanza. Thus is it always with the law-abiding man who trusts his government. The government misuses his trust. Then he learns. And with that education

comes suspicion, hatred, and a hostility to law. The government debases its citizens whenever it debases its currency. (It works both ways, of course: "a little" inflation is popular with many debtors because there is larceny in their hearts.)

The Soviet Union found from the beginning that full socialism, which involves restraints on private production and private profit, creates shortages and crises so horrible that there has to be some sort of backtracking from the official ideology. Hence Lenin's New Economic Policy (NEP) in the early 1920s: small businesses were allowed increased economic freedom. Hence the half acre private, family garden plots in today's U.S.S.R., which produce something like one-third of the country's food. Food is more important than ideology. Hence the laxity in enforcing laws against unofficial barter and black market activities (called "blat").[2] Whenever Stalinist ideologues temporarily get tough on black marketeers, the central economic plan smashes up on the rocks of shortages and delays. These political fluctuations between controls and modified economic freedom make true cynics out of the population. Cynicism is perhaps the one item which economic controls can produce in abundance. After painful obedience to irrational rules comes guilty participation in the survival markets. After guilt erodes, only cynicism remains. Cynicism and fear. And a secret lust for vengeance.[3]

Stage Four: feudalization and the destruction of money. Price controls—laws against the most important form of tax evasion—invariably disrupt markets. Unofficial markets replace the hampered official markets. Barter replaces monetary calculation. The division of labor drops as the size of organized markets shrinks. Productivity collapses. As money breaks down as a means of exchange, non-monetary income becomes all-important.

This is the remarkable genius of market responses to artificial impediments: some men always find ways of escape. When the inflation tax is imposed, men flee to hard goods. When it becomes illegal to flee to hard goods on the legal markets, they flee to hard goods on the illegal markets. When money transactions finally break down, men begin to escape from the money economy, or at least the official money economy.

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2. Joseph S. Berliner, "*Blat* Is Higher Than Stalin," in Abraham Brumberg (ed.), *Russia Under Khrushchev* (New York: Praeger, 1962), pp. 155-75.

3. This motive is *envy*. I have surveyed its economic effects in my book, *Successful Investing in an Age of Envy* (Ft. Worth, Texas: Steadman Press, 1983).

At the end of an inflation, the tax finally fails to do its confiscatory work. All taxes are denominated in money. Money is being destroyed. *By delaying payment of taxes, legally or illegally, citizens find it easy to pay their obligations.* They sell a hard good or service for paper money and pay their tax—the exchange now drawing twice as much in currency as it would have drawn a quarter or a month or a week earlier. The governments at all levels in Germany were paralyzed by this problem in 1922-23: they could not collect the taxes fast enough, and by the time they spent the money that had been taken in, it had declined again in purchasing power.[4] The government fouls its own nest so efficiently that every time it tries to get out of the nest it slips, falling ever deeper into its own waste. In the final stages of a mass inflation, those who are hurt most by this invisible tax are those who are employed by the government in all but the highest levels of the bureaucracy, those who are dependent upon the government for welfare payments, and those who believe in what government officials tell them, e.g., that U.S. savings bonds are a fine investment for one's retirement.

Strategy for Survival

Stage One: official compliance. Understand that long-run survival in the coming inflation tax deluge requires flexibility. It is nice to have a clean record, governmentally speaking. It is nice not to have government officials with a personal vendetta for you. If you want to avoid visibility, and if you are unwilling to pay the "anxiety tax," then pay up, unless you are convinced that by not paying you have a better chance of reducing your visibility. There are some tax resisters who think this is the case. But the really successful resisters are nomads who deal in cash and who are always on the move. Nomads can and probably will escape. The country is not going to be rebuilt by nomads. Yes, today's level of taxation is immoral. The means used to enforce the tax laws no doubt involve legalized extortion. The uses to which your tax dollars are put are clearly preposterous. Pay up, unless you are willing to take the legal consequences. Understand that the worst is yet to come, and that survival depends largely on a clean record. *You are buying invisibility*—a very valuable future good. Stage One is probably behind us.

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4. Constantino Bresciani-Turroni, *The Economics of Inflation: A Study of Currency Depreciation in Post-War Germany, 1914-1923* (London: George Allen & Unwin, [1931] 1953), pp. 65-66.

Stage Two: speculation. When you see the second stage of mass inflation coming (as I think we can), take evasive action. Buy up distressed property. Buy at auctions. Buy future alternative monies: gold coins, silver coins, common caliber ammunition, high quality liquor, etc. If you use debt, make it short-term (there may be another credit crunch ahead[5] — we can never be certain). Make sure it is within your power to pay it off by liquidating a present asset. Use compensated leverage.[6] Do not extend yourselves beyond your means to pay, in case a temporary credit crunch comes before the final inflationary blow-off. Speculate in goods, not with your survival. If you think you absolutely have to have something, own it outright. The main thing is to prepare yourself psychologically for the tax system that is the system of the future: mass inflation. If you think you will have qualms about buying and selling on black markets, buy what you think you will need right now, before such purchases are either impossible or illegal. I think we're in Stage Two.

You must also come to grips with the *morality* of this strategy. You are preserving your family's future. You are not stealing from anyone. Anyone can enter the "auction market" at any time and outbid you if he chooses. You are only spending your money in the way that seems best to you. You are foregoing some purchases — a boat, a vacation abroad, a new car, etc. — in order to make different purchases. If you prefer to think of it in this way, you are making one kind of investment — hard goods — rather than another kind. But there should be no sense of guilt on your part. Most other buyers think a strategy like this is crazy. They could follow it, but they will ignore it until it is too late to begin it inexpensively. Why should you feel guilty? The government is the immoral agent when it declares price controls, or follows policies that lead to price controls. You are doing nothing immoral when you try to escape the effects of immoral State policies.

Stage Three: new life style. Repressed inflation paralyzes the modern money economy. Shortages will be everywhere. You will need a non-urban location, independence from public utilities, new (barterable) skills, and above all, invisibility. *Keep your principles visible and your profits concealed.* Live in that mediocre home with your mediocre clothes and your aging car. Fly coach. Lend a helping hand. If

5. Written in spring, 1975.
6. See below, pp. 278-79.

you've got it, don't flaunt it. Cynical citizens who have lost everything to the inflation tax will be seeking vengeance. Stay out of their way. Remember: *most people will not escape the coming debacle.* The worst tragedy in our nation's history, economically speaking, is steadily approaching.

You do not have to tell everyone you know why you are not "moving up" on the social scale. Frankly, your friends really aren't that interested in how high on the scale you are, just so long as you are lower on it than they are. In fact, they enjoy being above you, at least if you show no signs of envy.

There is something else to consider: the higher you are, the farther you fall. Stay off the high rungs of the ladder. If you appear to be living an average middle-class life style today, perhaps people will not notice if you continue to live a similar life style in the midst of a crisis. If you show no signs of "moving up," envy is less likely to be directed against you during hard times.

Stage Four: crafts and knowledge. The breakdown finally comes. Contribute directly to your community's production. This means that you must begin now to develop skills that will be salable in a time of reduced division of labor, when the monetary unit no longer functions efficiently. Find out who supplies what goods at what nonmonetary price. Pay your taxes in Stage Four—denominated in paper money—with all the enthusiasm you can muster; they have dumped the garbage on you, and now you can shovel it back to them with abandon. Get out of any remaining debt. And if anyone asks you how all these things came about, tell him. It all started in 1913: the sixteenth amendment (income tax) and the Federal Reserve System. (And, conservative political scientists might point out, the seventeenth amendment, also passed in 1913: the direct election of U.S. Senators.)

Conclusion

This stage theory of development is not absolute. Political changes could thwart it. It will take a major political transformation, however, to escape from a series of developments something like these. People are determined to achieve simultaneously two conflicting goals: to increase the number of the State's "goodies" and to escape the necessary increase of the State's "baddies," namely, higher taxes to pay for the expenditures.

There have been zigs and zags in the coming of these stages, but

don't count on a delay forever. People will try to escape the effects of the controls. The controls are taxes, and people like to avoid paying taxes. You had better be ready to implement this program while it is still legal to do so.

Understand, however, that I am writing these words in late 1982. I have no idea when you are reading them. You may have run across a copy of this book very late in the "game." All I can say is this: what I have proposed here is legal at the time that I am proposing it. Perhaps we are in Stage Three or Stage Four by the time you are reading my words. You have greater motivation to take action now than you would have had back in early 1983—or in 1977, when the first version of this book was published, or in 1975 when a few of the chapters appeared in *Remnant Review.* But your motivation is no longer unique. A lot of people now have the same motivation. You are now competing with them in the various markets. So the costs of getting started are a lot higher than they would have been in Stage One or Stage Two. Some people who did read this book early and took decisive action are now way ahead of you. If they have followed my instructions, you will not be able to spot them easily. They will not be talking about their success. But I will state the obvious: some people have profited from the government's disastrous policies, and they are not moral wretches. They have defended themselves against moral wretches—voters, politicians, and bureaucrats who believe in salvation by statist legislation. There is no reason for you to feel guilty if you now seek to defend yourself. Avoid envy—the desire to tear down the successful person—and others may be willing to cooperate with you in making your life easier.

The more successful you are in evading the effects of controls, the more vulnerable you are to the envious. Privacy counts. The politics of envy is the dominant force today. Hedge yourself accordingly.

11

THE FEUDALIZATION OF THE ECONOMY

In 1973, Doubleday published a startling book, *The Coming Dark Age,* by Roberto Vacca, an Italian technologist. Its thesis was simple enough: the modern world has relied on a technological superstructure that is far too complex for men to predict or control. With the over-centralization of planning in every realm of economic life—planning based increasingly on computer models and computerized data—the modern world has opened the possibility of an unpredictable breakdown that would spread like the ripples produced by tossing a stone into a pool.

What kind of disasters does Vacca have in mind? For instance, he argues, consider freeway traffic. Generally, people will drive onto our superhighways so as to minimize their participation in a massive traffic jam. Other things being equal, men prefer to avoid bumper-to-bumper traffic. Voluntarily, men have learned to time their entry onto the highways to avoid jams. But what if there comes a day—statistically possible, given enough time—when too many people hit the highways simultaneously? The jam-up seems endless. Finally, people abandon their cars and walk away. Problem: How to unclog it in order to get the trucks in that supply a major urban area? New York City, says Vacca (and others), could last about three days apart from restocking from the outside. What if panic hit, either preceding the jam-up (fear of a bomb or a plague) or after the jam-up?

Then there is the power problem. What if another power failure hits, as it did in New York City and the New England area back in 1965? John Campbell, the late editor of *Analog,* the science fiction magazine, wrote an editorial a year after this famous power failure, painting a grim picture. Supposedly, there are two basic theoretical formulas that are supposed to show how such a failure could occur, only they do not agree with each other. After describing how the Massachusetts Institute of Technology's supplemental generator

was started up with automobile batteries, and was then used to start the silent generators of the Cambridge Power Company, which then fired up Boston's generators, which restored power to New England, Campbell concludes that no one can assure the public, using either of the two formulas, that such an event will not happen again.[1] Vacca has concluded much the same thing. The threat of a major power failure is increasing, as more people come under the administration of the power company bureaucracies, and their ability to deal with problems is unable to keep pace with the multiplication of these problems.[2]

The key problem is *price.* Vacca never mentions this aspect of the disruption of crucial public services. Again and again, the zones of continual catastrophe and crisis are those which are regulated by the municipal, state, or Federal governments, and which have prices dictated to them by politically influenced regulatory agencies. Power, highways, municipal services: all are either monopolies owned by the civil government, licensed by the civil government, or controlled by the civil government. The public brings pressure on these agencies during times of inflation. They are told to cut prices. This disrupts the whole capital structure of these companies. In the mid-1970s, a series of crises developed because of these pressures, and business news magazines sounded the alarm.[3] This is why it is dangerous to become completely dependent on public utilities to

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1. John Campbell, "The Best Made Plants. . . ." *Analog* (April, 1966).

2. The second New York blackout occurred while the first hardback edition of this book was being typeset: July 13, 1977. The result of this blackout was massive looting. The Congressional Research Service of the Library of Congress estimated the cost of this blackout at $310 million: *New York Times* (June 29, 1978).

3. "Utilities: Weak Point in the Energy Future," *Business Week* (Jan. 20, 1975); "A Phone Rate Hike Stirs Legislators," *Business Week* (March 17, 1975); "Switch in Plans: Electric Utilities Are Curtailing Expansion Programs," *Barron's* (March 10, 1975); "Those Shocking Electric Bills and the Complaints They Bring," *U.S. News & World Report* (Feb. 24, 1975); "Feeling the Heat: Workload, Criticism Grow for Regulators as Utility Rates Rise," *Wall Street Journal* (Jan. 28, 1975); William G. Rosenburg, "Utilities Need Help—Now!" *Wall Street Journal* (Jan. 8, 1975). The crisis continued throughout the 1970s: "State Utility Regulators Find Job Is 'Turbulent' As Consumers Battle Companies Over Rate Hikes," *Wall Street Journal* (May 23, 1978); "A Dark Future for Utilities," *Business Week* (May 28, 1979); "Utility Rates: New Political Dynamite," *U.S. News & World Report* (April 30, 1979); Steve Hanke, "Crisis-Ridden Water Systems Should Go Private," *Wall Street Journal* (Sept. 3, 1981); Susan Lee, "Electric Utilities: Thinking the Unthinkable," *Wall Street Journal* (March 3, 1982). A full-page ad sounded the alarm in the *Wall Street Journal* (Jan. 14, 1982): "Adverse Regulation Hinders Utilities in Capital Markets."

sustain your life style. Yet most Americans are almost totally dependent on them.

The problem of centralization cannot be avoided in public utilities. Decisions are not being made by uncertainty-bearing entrepreneurs who are fully responsible for their activities, and who suffer losses if decisions are not to the liking of the buying public. Decisions are being made by managers who are shielded by monopoly power from the full impact of their own mistakes. There is no open entry, with faltering established firms being spurred into action by newer, smaller, more creative firms. Price competition is not the principle behind the government-protected public utility's allocation of scarce resources. The existence of a free market is retarded, so the ability of managers to calculate costs and benefits by means of profit-and-loss statements is made more difficult. Without economic calculation, central planning agencies are unable to evaluate the contributions of the various parts of the total system.[4]

In a free market, entrepreneurs make mistakes. But they do not make identical, simultaneous mistakes (unless government policies, especially monetary policies, have lured them into error). One entrepreneur wins while another may lose. Therefore, there is *continuity* in the market's supply of needed goods and services. The existence of a freely fluctuating price mechanism informs suppliers of the goods and services in greatest demand; shortages are then filled rapidly. But when buyers are not permitted to bid up prices, the incentive for producers to shift production from a low-demand product to a high-demand product becomes economically unpredictable: Who has the most political pull, what are the priorities of the planning agencies, which disaster is getting the most publicity, etc? Without the *price mechanism* and *profit and loss indicators,* no one can have confidence in his safety. Those supplying him become far less efficient in supplying his needs.

Transportation

There is a kind of law of bureaucratic progression in the regulatory process. The first stage involves *subsidies* to a particular established group, usually in exchange for the right of the government to supervise the affairs of the guild. Granting semi-monopolistic

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4. Ludwig von Mises, "Economic Calculation in the Socialist Commonwealth" (1920), in F. A. Hayek (ed.), *Collectivist Economic Planning* (London: Routledge & Kegan Paul, 1935).

economic power to one group, the authorities feel compelled to make sure that such power is "used wisely for the benefit of the public." *Which* public is left undefined.

The next stage is *increased intervention.* Vested interests clash: buyers vs. sellers, excluded sellers vs. established sellers. Everyone wants the favors granted by the government. The regulators increase their intervention in order to balance the many demands of the various interest groups. This decreases the profitability of the once-subsidized members of the protected segment of the market. It may produce bankruptcies, especially since managements are now less efficient, being accustomed to continual grants of semi-monopolistic power.

The third stage is *outright control by the Federal government,* since bankruptcy threatens the industry. It should be obvious that this outline fits the railroads of the East Coast rather well. Three generations after the original grants of power were made by the Interstate Commerce Commission, the eastern railroads were about to be nationalized. Then we were treated to the spectacle of businessmen getting on board the nationalized railroads. "Shocking as nationalization may have been a couple of years ago," wrote the editors of *Business Week* (March 17, 1973), "it now seems to be the only workable solution left. . . . Nationalization—even of decaying facilities owned by bankrupt companies—is never easy for businessmen to accept. But under such circumstances, nationalization of the rails is the only way out." Frankly, the nationalization of any business which is used by other businessmen at below-market rates is so readily accepted when nationalized that it boggles the imagination. To hear a businessman complain about nationalization is about as amusing as hearing one of Xaviera Hollander's guild associates insist that she's not that kind of girl. Not at some ridiculously low price, anyway.

There is a way out, contrary to *Business Week.* Deregulate the railroads. Allow any entrepreneur to bid on the value of the existing property. Allow him to run as few and as many trains as he chooses, over which tracks produce the greatest return, at any time of day. Then deregulate the control of trucking, in order to give the railroad managers a strong incentive to keep prices down. Then deregulate the airlines and air freight.[5] Do all of this day after tomorrow, and

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5. In the five or so years since I first wrote this, both trucking and the airline industry have been steadily deregulated. The results were predictable: a drastic slowing down of prices in the most heavily used routes. Price competition works.

within a year your problem will be pretty-well solved—if it takes a year. In principle, it will be solved; it may take time to work out the operating solution. Meanwhile, everyone will have to pay the full costs of the transportation services received. No one, least of all the businessman, wants to do that if he has been receiving a subsidy.

Transportation is the Achilles' heel of the cities. The miracle described a century ago by Frederic Bastiat—the fact that milk appeared on the Paris doorstep of everyone who ordered it, each and every morning, despite the fact that no planning agency directed such affairs—rests on *free entry* and *free trade.* Take away these supporting pillars, and the guaranteed deliveries become erratic. In Paris during the French Revolution, revolutionaries deliberately impeded the delivery of bread to the city; the result was increased panic and rioting, including attacks on bakers who dared to hike prices in response to higher demand. This could happen again. In any case, the imposition of licensing requirements retards entry into the trucking industry, and in a time of price controls, the ability of individual consumers to predict with precision just who will be shipping in goods will be drastically reduced. Bottlenecks of production are bad enough, but bottlenecks of the supply of goods to an urban population could be politically explosive.

What happened during the mass inflation of the French Revolution should serve as a warning. Andrew Dickson White, the first president of Cornell University, wrote a book on this period. Here is what he reported:

> The washerwomen of Paris, finding soap so dear that they could hardly purchase it, insisted that all the merchants who were endeavoring to save something of their property by refusing to sell their goods for the wretched currency with which France was flooded, should be punished with death; the women of the markets and the hangers-on of the Jacobin Club called loudly for law "to equalize the value of paper money and silver coin." It was also demanded that a tax be laid especially on the rich, to the amount of four hundred million francs, to buy bread. Marat declared loudly that the people, by hanging shopkeepers and plundering stores, could easily remove the trouble. The result was that on the 28th of February, 1793, at eight o'clock in the evening, a mob of men and women in disguise began plundering the stores and shops of Paris. At first they demanded only bread; soon they insisted on coffee and rice and sugar; at last they seized everything on which they could lay their hands—cloth, clothing, groceries and luxuries of every kind. Two hundred such places were plundered. This

was endured for six hours and finally order was restored only by a grant of seven million francs to buy off the mob.[6]

Such actions by the State are always seen as necessary, just as nationalization of the railroads today is seen as necessary by certain business interests. These acts are seen as mandatory only in a world where men are not free to pursue their callings as they see fit.

The threat of confiscation only puts a premium on hiding signs of one's production. It pays to lie about what you have produced. This inevitably fouls up the computerized print-outs that are so crucial to macroeconomic planning. The data are progressively debased, along with the paper money. It also puts a premium on barter.

Barter and Local Contacts

The medieval economy, like any preponderantly rural economy, was highly personal. Each man knew his supplier. The extent of the market was limited. Personal contacts were of great importance. This is one very important reason why Jews had a competitive advantage in international trade: family and religious contacts within this ostracized segment of the population were elevated in importance. But there really was not much trade, given the high costs of transportation. Bulky goods did not move very far from major waterways. Barter was basic to the economy, and face-to-face contact between producer and consumer was the standard operating procedure of that era.

Today, consumers almost never see the actual producer of any good. Middlemen provide transport services, retailing, and so forth. Money talks. Bookkeeping entries rule. But when price controls disrupt the reliability of supplies, as producers drop those items that no longer produce profits, the State will be tempted to intervene and demand that certain items be produced at a loss. This is no different, in principle, from the requirement by the Civil Aeronautics Board (CAB) that certain flight schedules be maintained in spite of the losses they produce, or the Interstate Commerce Commission (ICC) rules that certain train schedules be maintained.[7] Then there will be a temptation to dilute product quality as a cost-cutting

6. Andrew Dickson White, *Fiat Money Inflation in France* (Caldwell, Idaho: Caxton Printers, [1914] 1958), p. 48.

7. As mentioned earlier, these rules have been relaxed since the mid-1970s.

measure. The productivity of the overall economy will deteriorate. Independent middlemen will be squeezed out of business, as "vertical integration"—ownership from top to bottom by one firm, as a means of avoiding the bottlenecks produced by price controls—replaces multiple ownership. The free flow of goods and services will be impeded, but goods more than services. Goods leave more records. Records invite investigation.

At this stage, black markets will spring up. These will be markets on which money rules only in part. Safety considerations will put a premium on personal contacts—reliability. This, of course, was the basis of the Capone empire and the other gangs of the 1930s. Those who run the black markets are all too often unsavory characters who are willing to take risks and break laws. But public demand will register itself, and suppliers will be found. Local communities will be able to circumvent both government controls and the Mafia only by imitating the black market supply mechanism on a local level. Personal contact will be more important than it is today. On the other hand, the very requirement for personal contact will reduce the extent of the market, simultaneously reducing the division of labor.

There are other factors that tend to increase the reliance of the buying public on barter. One is the fact that goods which are not priced in terms of money, but are traded directly, are much more likely not to be reported on income tax forms, or if they are, at reduced rates. The imputation of monetary value is more difficult. Furthermore, bartered goods do not leave records in a bank account. Finally, bartered goods need not be sold at official money prices—controlled prices. This is why price controls increase the likelihood of barter.

It must be understood that barter is accompanied by a collapse of productivity and the reduction of almost everyone's income. It is not an efficient system. But it is more efficient than the repressed economy of price controls. This is why it would pay people to become familiar with swap meets, auctions, local bazaars, "flea markets," and all other similar institutions. There will be a day when knowledge of "junk" may mean survival. The proverbial horse trader may be seen again in some parts of America. It would be wise to start making contacts now if you are already in a rural area.

The Role of the Churches

There is little doubt in my mind that the local churches, with their

face-to-face contacts, their family atmosphere, and the strong element of self-help that should be present, will become important centers for establishing lines of supply. They are obviously one institutional means of overcoming the burdens of a declining division of labor. They can be centers of local leadership, too, and where they take on social responsibilities they will simultaneously become centers of local power. There is an old rule: *power follows responsibility.* This certainly has been true in the history of the American Negro. The local church was more than a narrowly defined place of religious worship. Poverty and a lack of community leadership placed great power into the hands of local pastors. Martin Luther King was not a lawyer, after all. Elijah Muhammed had more power than a typical Chicago alderman. The churches are continuing institutions, and this very feature grants to the churches tremendous power in a time of institutional crisis and economic breakdown.

The problem, of course, is that today's churches are seldom fit to exercise leadership. The social gospel denominations have generally forfeited the support of the laity. They have squandered the capital of generations of faithful (and not too wise) giving. They are in deep trouble, both financially and in terms of the confidence of the members. But the conservative fundamentalist churches have been burdened with a retreatist pietism for a century.[8] Only since the late 1970s have fundamentalist churches and leaders begun to get involved in political action—to the horror of the old-style political liberals who always believed that Christian ethics meant New Deal politics. But the fundamentalist churches are unprepared for the kind of responsibility that serious economic breakdown would place on them. How many deacons have been trained in their jobs? How many understand the biblical responsibilities, let alone the financial responsibilities? Not many.[9] But the diaconate will have tremendous pressures placed upon it in a time of economic shortages. We have not raised up a school of the diaconate, any more than we have raised up a school of prophets. Thus, a basic local institution has not

8. George Marsden, *Fundamentalism and American Culture: The Shaping of Twentieth Century Evangelicalism, 1870-1925* (New York: Oxford University Press, 1980); Timothy P. Weber, *Living in the Shadow of the Second Coming: American Premillennialism, 1875-1925* (New York: Oxford University Press, 1979); Louis Gasper, *The Fundamentalist Movement, 1930-1956* (Grand Rapids, Michigan: Baker Book House, [1963] 1981), pp. 121-22.

9. Gary North, "Diaconal Training," *Tentmakers,* V (Nov./Dec., 1982), published by the Institute for Christian Economics, P. O. Box 8000, Tyler, TX 75711.

prepared itself for what would seem to be coming.

Even more disastrously, until quite recently—since the first edition of this book—few leaders in the churches have sounded the alarm. The last people who seem to know what is happening are the members of the local conservative or fundamentalist denominations.[10] They have a kind of gut-level conservative reaction to the drift of modern society, but they have done nothing, or next to nothing, to begin to work out alternatives for a time of crisis. Pastors who can get seventeen sermons out of Noah and the ark and five year's worth out of the typological meaning of the wilderness of the exodus, seem unable to comprehend the specifics of either. Thank God that He promised not to bring the flood again; if He planned to use it, the modern Christians would be hard-pressed to come up with anything more impressive than a handful of rowboats (excepting the Episcopalians, who might have a cabin cruiser or two, and these would be heavily mortgaged).

Members of the local churches should take it upon themselves to see to it that they know about each other's skills. They should meet in homes, if necessary, to develop the marketing of these skills. Perhaps some men could decide to take a course in a particular craft with the crafts complementing those skills possessed by other members of the congregation. If these meetings could become community-wide, so much the better. Women could meet together to share ideas on gardening, sewing, and other crafts that would be helpful during a time of reduced productivity. Children should be encouraged to develop skills, especially during summer vacations. A group of adults could locate and hire the services of some retired craftsman and bring him to the church or private school for training purposes. The demise of the apprenticeship system has not yet been seen for the disaster that it is. A depression, or mass inflation with controls, followed by a depression, will call the loss to our attention.

The Revival of Craftmanship

Back in 1970, I wrote an essay, "Inflation and the Return of the Craftsman." I argued that the imposition of price and wage controls would disrupt the normal markets for goods and services and place a

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10. The coming of Pat Robertson's "700 Club," with its satellite T.V. communications and its focus on contemporary affairs, has changed much of this for the better. See Gary North, "The Importance of the 700 Club," *Biblical Economics Today,* V (Feb./March, 1982), published by the Institute for Christian Economics.

premium on the production of relatively simple goods. In other words, the controls invariably reduce the division of labor, and this in turn bankrupts industries that are too specialized, especially industrial firms. Thereafter, we should expect to see a revival of interest in goods produced by simpler production processes. Those who have the tools and skill necessary for such production will, obviously, be immediate beneficiaries of the controls.

No conventional magazine would touch the article. I specifically predicted that Nixon would impose price controls, despite his assurances to the contrary. He did, seven months after the article was published. Only the counter-culture magazine, *The Whole Earth Catalog,* would touch it (Jan. 1971). (This article is reprinted in the next chapter.) I have not changed my mind. I would strongly recommend a good apprenticeship program or trade school for those with any inclinations and skills along these lines. The U.S. government operates a National Apprenticeship Program through the Department of Labor, and it would be wise for interested people to order booklets on the program from the Department's Bureau of Apprenticeship and Training of the Manpower Administration, Washington, D.C. 20210. A Christian apprenticeship program, Walk-Way, is located in Lock Haven, PA 17745.

This may turn out to be one of the major benefits of price controls. Repairs will be the staff of life. If you are unable to buy new manufactured goods at the artificially low prices, then you will have to shell out the money to keep what you have operating. This is where the incentive factor enters the picture. Young men will see the advantages to learning complex skills. They will have to seek out older men to learn some of these skills, since the schools seldom provide craft training, and certainly not in local communities that are too far from a junior college to commute easily (especially under gasoline rationing). The master teachers of the world may find that economic necessity is the mother of harder-working apprentices.

When we look at the horrors that Europe has seen twice or more in this century, we Americans are too apt to turn away and tell ourselves that we are completely different. But just because we have not seen this kind of economic disruption, even in the Great Depression, is no reason to assume that such events are in some way screened out by the ocean. On the other hand, Europe has maintained its artisan tradition longer than we have. If a breakdown should come, then at least we should make the best of it. We should organize ourselves to meet the difficulties creatively. It is unlikely that churches will take

these steps in advance, but sooner or later they must face the fact that there are no political and economic vacuums, and that an institution as central as a church cannot evade the responsibilities of leadership forever.

The 8th chapter of Deuteronomy sketches the development of a godly society: covenantal faithfulness produces blessings; the external blessings produce forgetfulness; forgetfulness produces judgment and disaster; and disaster is supposed to call a faithless people to repentance. The destruction of Isaiah, Chapter 1 is followed by the restoration of Isaiah, Chapter 2. Hopefully, the disruptions that seem so inescapable today will be of this nature. We will use our economic trials to learn new skills, including the skills of leadership. This has to be done in local churches.

The feudalization of the economy will impel men to exercise their talents to meet local needs. They will be forced to learn who their neighbors are and what they need and can produce. What we lose in efficiency we hopefully will compensate for in increased neighborliness and co-operation in the community. The wealth of urban life brought with it isolation, anonymity and loneliness. Perhaps the loss of wealth will help us to regain what we lost long ago.

In any case, if the churches and local voluntary associations refuse to carry the torch, the Mafia and other less voluntary groups will. It is best to place the leadership, including self-defense, in more reliable hands.

Conclusion

There are reasons to believe that technology will continue to become more decentralized. Adam Osborne's little book, *Running Wild,* tells the story of the spectacular development of the microcomputer industry right under the noses of IBM, the unions, and the State. Those people associated with the development of innovative new technology tend to be independent types. There are forces running counter to the centralization of power. If productivity can increase under decentralization ("feudalization") in the ways described by Alvin Toffler in his fascinating book, *The Third Wave* (1980), then we are on the brink, not of a dark age, but a highly productive age. But three scenarios could bring Vacca's dark age: a nuclear war, full-scale terrorism in our vulnerable cities, and the imposition and enforcement of price and wage controls. We had better be ready for bad news.

12

INFLATION AND THE RETURN OF THE CRAFTSMAN

[I could not find a publisher for this in the conservative press, so I sent it to that incredible magazine, The Whole Earth Catalog *(Jan., 1971). Amazingly, some of my radical acquaintances on the campus and off found it persuasive. I received a letter from one lady, obviously a hard-working "proletarian" of relatively little formal education, who said her college senior daughter had given it to her and had said, "This is what you've told me for years, but I never believed it before." Unfortunately, truth is not always it own best testimony in our world; where it appears or who says it is often what counts. But some of our "hippie" citizens have more economic sense than some of our presidential advisors on the Council for Economic Development. I wrote this in mid-1970. Obviously my timing was off. I had expected the imposition of wage-price controls in 1973 or 1974; Nixon beat me to it. My predictions were accurate for the 1971-73 period: no controls on art objects, collectors' items, used goods, and small businesses. Now, let's see if the rest of my prophecy comes true. I fear that it will.]*

Prophets are seldom popular men, even when they predict correctly. In the area of economic forecasting good men are often frighteningly wrong. Thus, the man who claims to know the future is taking a considerable risk; if he is wrong, he will look like a fool; if he is right, everyone will hate him (at least if he has predicted hard times). Nevertheless, every man has to be a bit of a prophet if he is to survive. There is no way of escaping personal responsibility; men must plan, at least to some extent, for their economic futures. If that future brings what I am fully convinced it must bring, a lot of white collar professionals are going to be disappointed, and a lot of hobbyists are going to reap very substantial economic rewards.

America's greatest economic bugaboo is depression. The memory

of the 1930s has left an indelible scar on the American mind. It would be politically safe to say that no political party, especially the party incumbent in the White House, will be willing to risk a depression; the results at the polls would be too devastating. In short, if the government should face an either/or situation of inflation or depression, it will choose inflation every time. There is evidence—I believe overwhelming evidence—that indicates this is precisely the dilemma we face today.

During the final months of President Johnson's administration, the Federal Reserve System (our nation's central bank) stopped the increase of new money coming into the economy. President Nixon continued to support the FED's decision for the first year in office. The results were (or should have been) predictable: increased unemployment, a disastrous fall in the stock market, falling industrial profits, and decreased tax revenues. Ironically, the end of monetary inflation did not bring an end to price inflation; people apparently could not bring themselves to believe that "tight money"—high rates of interest—and zero monetary inflation would persist. They did not believe that President Nixon would pursue indefinitely a policy of balanced budgets, reduced government expenditures, and higher taxes (which is the way you stop prices from rising). So labor and business kept passing on higher and higher prices to the consumer; and the man out of work, the marginal business, and the self-employed laborer found the economic squeeze disastrous. The general public kept bidding for goods.

Since last spring, the Federal Reserve System has reversed itself. New money is now being injected into the economy. The federal government's deficit (the difference between income and expenditures) is climbing again, and this means the central bank now buys government bonds with newly created credit-money—monetary inflation. Given the psychology of Americans in 1970, this will mean price inflation. A "reinflation" of the economy is beginning. What can we reasonably expect? The cost of living index will climb in the 1970s as never before in peacetime America. Price inflation is beginning. Price inflation is the symptom of a previous monetary inflation, and we should expect to see prices rise at an increasingly frantic clip. When this happens, there is always great public pressure put on the government to impose price and wage controls. People do not understand that rising prices are a symptom of a

deeper cause, namely, the increase of the money supply (fostered primarily, though not exclusively, by federal deficits). They call for a suppression of the outward symptoms. It would not be surprising to see the incoming President in 1973 forced to begin the imposition of price controls sometime during his administration. The Congress has already granted this power to President Nixon, in spite of his protests. Power once granted is generally used sooner or later.[1]

Many readers will remember the effect of price controls during World War II. There were shortages everywhere, and all of these shortages were not the exclusive responsibility of the war effort. Anyone who has lived in a foreign nation during a period of price controls knows what can happen, even in peacetime. Anyone trying to rent a decent apartment on Manhattan Island today knows the effect of rent controls: heavy demand and no supply. Lots of money, but very few desirable goods. Since it is more difficult to make a profit in controlled industry, labor, capital, and raw materials tend to go into the uncontrolled industries where greater profits are likely. So the market for industrial goods begins to dry up. You cannot buy a home appliance easily, and new automobiles get scarce, and electrical goods disappear. And the available goods get shoddier as manufacturers are forced to cut costs to make ends meet. We are already seeing this to some extent, as inflation takes its toll; with price controls, these effects on workmanship are amplified.

If I am correct in my analysis of inflation and in my prediction that more inflation is likely, then the reader should begin to see what is coming. The man who plans carefully at this stage stands to survive the price-wage squeeze, the shortages, and the defective workmanship that are on their way. The hobbyist has one item that will rise in value, will be marketable, and will be in heavy demand: specialized knowledge. In some cases that knowledge will be so valuable that a hobby may become a new occupation for those men who take advantage of new conditions. For white collar workers, or those associated with heavy industries that will be hit hard by the economic controls, their skills in the home shop may be more profitable than their skills in the factory or office.

Why should this be the case? Because the official lines of supply

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1. Controls were imposed on August 15, 1971, seven months after this essay was published.

will be increasingly empty of the desired goods and services. The black market—an inevitable effect of price controls—will begin to absorb the goods most heavily in demand. It always has in the past; there is little reason to expect anything different for the future. Those with power or prestige or other goods to trade will absorb the supplies, leaving the rest of the population to stand in long lines in front of half-empty stores. The difference between the demand (at the official, legal prices) and supply is where the hobbyist enters his glory. One thing which we can expect to see is that new household electrical appliances and similar manufactured goods will become more difficult to obtain. Governments always place price and wage controls over those industries that are large enough and "vital" enough to be worth the effort to control. All industries are not equally subject to controls. Controls are put on such things as mining, steel manufacture, metals of all sorts, electronics, and automobiles. (About the only industry generally left free in the past has been farming: it is a highly competitive market and constitutes a major voting bloc.) Local businesses involved in retailing any of these products are faced with a man-made crisis: shortages of goods and rising wage demands by employees. Capital flows out of these areas of the economy and into the so-called "luxury" trades: antiques, art collecting, coins, stamps, rare books, rare wines and liquors. All of these industries have experienced rapid price increases since 1965, the year inflation began to be felt by the general public. When price controls appear, their expansion will be that much greater, as more and more people pour a depreciating currency into goods that are not under price controls.

If manufactured goods, especially home appliances, get scarce, then the home repair expert experiences a bonanza. People have to make-do with the old washing machine or refrigerator. The day that price controls are declared, the intelligent buyer will go down and buy every \$25-\$30 used refrigerator he can store. He will buy old broken motors from junk stores. The junk store man, if he is smart, will try to increase his supplies, holding inventories for as long as possible, waiting for the economic boom. It will not be long in coming. When price controls are in effect, a startling effect is produced: the price differential between new and old goods begins to narrow. In some cases the differential may even shift in favor of the used goods: the used good is not under price controls, while the new good is. People can bid up the prices of used goods in a way that they can-

not with the new goods. They can buy what they are willing to pay for—but only in the used goods market. If price controls were imposed in 1975, by 1980 a man might be able to triple his original investment. He could do far better if he were a repairman who had bought junk discards to begin with. That is a good return on one's money; the stock market will never match it, for controls invariably spell the death of blue chip capital stocks; it is these industries that are placed under the controls first. Controls, by definition, are intended to reduce profits.

The demand for repairs will skyrocket, but the larger unions—plumbing, plastering, carpentry—are likely to be placed under wage controls. Being more visible, and being organized into a guild, these fields will be more easily controlled by government boards of officials. The result will be a fantastic increase in labor's black market, or as it will be called (as it is called today), "moonlighting." A professional will spend as little time as possible on his official job, saving his skills and energy for his "underground" occupation. Even if the unions escape controls, the market for the amateur repairman will expand as people refuse to pay the going unionized wages. We have seen this take place already.

There is another factor to consider. A dollar saved is a lot more than a dollar earned. An earned dollar is subject to taxation; a saved dollar is not. As people begin to understand this basic economic fact, they will make use of their own skills, or their neighbor's skills, to get repairs done cheaply. We can expect to see neighborhood service exchanges set up, and woe unto the man who does not have a skill to exchange.

The demand for repair manuals and how-to-do-it books will increase, and so will prices for such publications. The smart individual will buy his 3-year subscription to a home repair magazine the day following the announcement of price controls. Editors of many popular magazines will begin to face basic changes in their economic parameters. Paper costs will either soar or else paper will become very scarce (due to controls); advertisers will not be willing to pay high prices for advertising, since all the goods they have to sell will be bought anyway. Men will advertise in order to obtain supplies; thus, the money will be made in classified advertising. The repair journals and the collectors' journals will reap the harvest of these subscriptions, for it will be through information in these hobby publications that men will find answers to critical problems. The

man with specialized knowledge of these markets and these skills will be in the driver's seat.

Hobbyists will notice another phenomenon. There will be a vast new audience for the hobby industries. Being essentially "luxuries," they will be the industries free from controls. (The controls are at first reserved for "vital" industries.) With money to spend and few products to buy, people will begin to increase their expenditures on luxuries: travel, camping, entertainment, and all forms of do-it-yourself tools and materials. The amateur hobbyist who has amassed considerable knowledge over the last few years may find himself a profession, for knowledge is not a free economic good. It takes time, discipline, and usually money to obtain it. I would therefore expect to see amateur hobbyists establishing local informal schools (or perhaps even franchised schools) that would impart skilled knowledge at a price. Neighborhood evening schools will become common. Some men may have specialized libraries that can be made into reference libraries at a profit. Where there is heavy demand, some men will find a means of converting such demand into personal benefit. Knowledge does not come easily; it will not be sold cheaply.

This has led me to an odd conclusion (for a college instructor). The young man who has skills mechanically would be wise to stay out of college. He would be far wiser to get into a trade school, especially if he should have a skill that would not require highly specialized machinery. With some 8,000,000[2] young men and women on the college campuses today, there will be a glut of people holding college degrees. In fact, the glut is already quite visible. The automatic job for the man with the bachelor's degree is not automatic any longer, at least not at the older higher wage. The skilled craftsman is about to have his day. The man who can produce a thing of beauty or of use through his own genius, with simple tools and common materials, should find the coming decade exceptionally profitable. If he must sacrifice the false prestige of a college diploma in order to get such skills, the sacrifice ought to pay off in the future—perhaps the very near future.

The 1970s and the 1980s may well destroy the whole economic structure that is based on the "organization man"—the drone who substitutes activity for production, a glib tongue for knowledge. The

2. Up to 11,000,000 in 1976.

days of the instant success through college are numbered; there are simply too many people in college for any monopolistic reward to be maintained by holders of the college degree. Men with skills and knowledge will continue to be paid well, but the skills and knowledge required for economic survival may not be those imparted by formal college instruction. Prestige will come once more to the man who can build with his own hands, the creative person, the man who possesses operational knowledge of how simple things work. For that kind, the bonanza is about to begin.

13

EMPLOYEE RELATIONS UNDER PRICE CONTROLS

We live in an economy which is a truly political economy. It is government which controls the money supply's basic aggregates, although citizens can influence monetary results to the extent that they cash in savings accounts (or create them), or cash in checking accounts in order to hold currency. That, in fact, is the original meaning of "cash-in." If the currency is not redeposited by some recipient of the cash, the overall money supply is reduced, since the banks cannot multiply cash held outside the banking system. Cash is not fractionally reserved, in other words.[1] But on the whole, the government controls the money supply, since the Federal Reserve System will capitulate to the government if the President and Congress are agreed on a particular monetary policy.

This means that the fiat-money-induced boom-bust cycle is the product of misguided or malevolent government policy. The politics of inflation and the politics of envy combine to create the universally inflationary economies of Western Europe (yes, even including Switzerland), Asia, Latin America, Australia, and Africa. The only continent which is not presently experiencing inflation is Antarctica. This means that professionals, employers, and corporate managers must find ways to keep their business operating after price and wage controls—especially wage controls—bottle up the productivity of the free market. Controls may seem far away today, but inflation is certainly with us, the boom-bust economic cycle is still with us, and it is not too difficult to predict the advent of that old political program of

1. The cash component of the money supply has been growing steadily. If you divide the Federal Reserve's announced figure of "cash in circulation" by the 225 million U.S. residents, you get a figure of over $675 for every man, woman, and infant. This figure is incredible, but we are asked by the authorities to believe it. Can you imagine every family of four with $2,700, cash, in its possession at all times? The "underground economy" is apparently massive. In Florida, it is more than massive. It is a way of life.

last resort, controls. He who ignores them will find his business disrupted, sooner or later. Probably sooner.

The Pressures on Professionals

Men who do their work well, meaning better than their competitors, are subject to considerable psychological stress, and sometimes even killing stress. The stress can become physiological. Men feel driven to stay ahead and improve their business. Such men want recognition of their performance. They tend to be perfectionists—a dangerous goal in an imperfect and decreasingly efficient economy. Very often, they drink too much, work too hard, and die too young. The slogan of Alcoholics Anonymous, "easy does it," is literally a life-saver for some of its members. These are men, in many cases, who almost destroyed themselves by ignoring the limits on their own human capacities. Their labor was intensive, but they could not keep up the pace they had set for themselves.

There is a loss to society when this happens. We may enjoy the services of the self-driven producer, but then we lose when he can no longer produce. In certain key fields where the progress of the profession is cumulative and very rapid—the sciences, law, medicine—the loss can be even greater. It takes so long to gain the professional skills, gain the necessary experience, build up self-confidence, build up confidence among one's potential customers, increase output, and stay on top of the field, that an early death or crippling sickness is a mini-disaster to the profession and those served by it. One of the chief goals of this brief book is to help men to increase their income, but never forget that this means that each man must increase his output over the long haul. The pressures placed on conscientious managers by price controls are horrendous, and they grow worse over time. The more of a perfectionist you are, the more you should concentrate on relieving expected future pressures while you still can. Controls-induced shortages create problems that cannot be solved by the managerial equivalent of the proverbial Chinese fire drill.

The Division of Labor

Without the existence of a market system, and primarily a money economy, the division of labor collapses. This is the chief economic (as distinguished from moral) threat offered by full-scale price and wage controls. Men cannot rely on the performance of contracts by

others. This makes the delegation of responsibility that much more difficult. Yet the delegation of responsibility is vital if the effects of the perfectionist's mania are to be overcome. "Please, mother, I'd rather do it myself," is a sure-fire formula for disaster when markets get creaky as a result of the distortion of prices.

The key question ought to be the *total output* of *everyone* working on a project or in an office. No doubt there are some managers who can perform the major tasks better than anyone else in the organization, but the central issue is total output. A century and a half ago, David Ricardo defended the free market system of free trade by pointing out if there are two nations, and one can produce both apples and oranges more efficiently than the other, it should nevertheless concentrate on what it produces most efficiently, leaving the production of the other product to the second nation. Total output goes up. A good manager is one who can get the division of labor working for his organization.

The high-technology, high-education, high-profit tasks should be performed by those few individuals who can handle them best. Find the job which only one or two men can handle and fill it with the best man, even if he can also do the best job on half a dozen less specialized tasks that others can perform, albeit less efficiently. Those highly specialized producers owe it to themselves, their business or organization, and especially to the consumer, to force themselves to concentrate on the tasks that they, and they alone, can perform.

All this may sound trite. But in a time of controls-induced rigidities, it is absolutely imperative that managers and owners discipline themselves to deal with the reality of the division of labor. No one in a professional position denies the fact that some office tasks—answering the telephones, filing forms, going for coffee—should not be part of his normal schedule. A professional in a large company should not serve as a part-time clerk. Yet how much attention do professionals give to the problems concerning clerical help? How many seek out opportunities for transferring responsibility downward? Not enough.

Costs of Replacement

Say that by some miracle, you have located a competent secretary. Someone who shows up 15 minutes early, remembers all of your appointments, can make sense of your billing methods, keeps your customers happy, and brews a good cup of coffee. What is she

worth? To estimate her value, try to estimate what it would cost you—really cost you—if she were to quit. First, there would be the applications and the screening of a replacement. Think of interviewing dimwitted teeny-boppers (of whatever age) who are the flower of our government-financed educational system. Think about the confusion in your office during the screening process. Think about the possibility that you, out of desperation, might hire one of these dunderheads. Think of the disruption and problems that will accumulate until you fire her and start the search all over again.

If you think this is a joke, start looking into the future three to five years. When wages are frozen by law, and prices are also frozen, your office or company will start getting hectic—more confusion in billing (you run out of forms, and your supplier is out of stock), long delays in getting paid (the "it's in the mail" syndrome), endless government forms to fill out—the only forms, I hope, which will run out of stock permanently. Meanwhile, you are not permitted to raise the salaries of your clerical help. Clerical jobs are now unpleasant, but you are forbidden by law to match the increase in frustration with an increase in salary. That nice, sensitive, competent assistant or typist or clerk finally breaks out in tears. "I quit!" she announces, and promptly walks out. It really is not worth her trouble any more. She can stay home, do some typing on the side (at black market prices), pocket the cash, fail to report the income, and do quite well, thank you. She can go on welfare for less trouble. The sensitive one will quit first.

What are you able to do about it? The market for competent secretarial help is already a seller's market today; what about under controls? When wages are frozen, the employer is prohibited from entering the labor markets and competing by means of wage increases with his competition. The competition is not simply other harried corporate executives; the competition includes leisure, black market opportunities, government hand-outs, self-employment. How will you convince some competent replacement to come in and straighten out the mess, or at least try to straighten it out? This is no laughing matter. A man's professional career may hinge on his being able to answer this question.

Non-Price Incentives

As always, the entrepreneur who will prosper under controls will be the man who can seek out legal alternatives to the money-

denominated price system. It is not a good use of his time in comparison with what he might accomplish under free pricing, but it is necessary for survival. In the case of secretarial and clerical help, studies have indicated that women respond better to improved working conditions than they do to a comparable amount of money spent directly on salaries, compared to the way men respond. This is economically rational, whatever psychological reasons may be involved. First, women are not usually the primary family breadwinners. (Those who are will really suffer under wage controls.) Second, a money raise puts the family into a higher tax bracket, so that non-monetary incentives, which are consumed directly and are not taxable, can be effective even under free pricing. A professional who yells at his secretary when he is under pressure had better find a way to keep from getting under pressure. Or he had better start disciplining himself to control his temper now, before controls are imposed. A man whose office is continual bedlam is asking for trouble. He will be at a competitive disadvantage under controls. It might even pay him to have a management consultant come in and rearrange his office's organization. By reducing office tensions, these well-paid consultants can improve efficiency now, and insure economic survival later. (A wise consultant would today be thinking through the implications of non-price competition; he will need that knowledge soon.)

Another effective means of non-wage competition is the judicious use of a promotion. A truly competent secretary should be made an executive secretary, preferably before controls are imposed, certainly immediately after they are imposed, and absolutely once labor shortages appear. People are status seekers as well as income seekers. They want others to understand their value to a firm, and a title is one means of insuring such recognition. With a promotion in title, the promoted worker should have more responsibility—true responsibility. If possible, the promoted secretary-clerk should have a full-time or part-time assistant. Again, the principle of the division of labor must be recognized and honored in the price control breach. It is absolutely imperative that people be paid in direct proportion to their economic contribution to production. Price controls make this wage-production relationship very difficult to ascertain with accuracy, but managers must try to discover it. Every worker must be paid in terms of the cost of replacing him or her. The more successful a man is in determining this cost, the more likely he is to survive economically.

Prior to the imposition of controls, businessmen would be wise to use some form of the bonus system of compensation. I think that bonuses are superior to simple salary increases. They stimulate people to greater output. Bonuses, not being "owed" directly and regularly, are not mentally classified in the category of "minimum expected payment," which then serves as a launching pad for even more wage demands, whether actual or mental (i.e., resentment against management for not offering a raise). When raises are given, household budgets are expanded and even over-extended (thereby requiring another wage increase). Bonuses, on the other hand, are seen as special rewards for special efficiencies. Furthermore, a tradition of bonuses established prior to controls might give a manager some leverage in the future. Obviously, price and wage regulators will regard bonuses as disguised raises. The firm that has a long tradition of bonuses may escape the controllers for a time. (Frankly, I doubt it. No one pays bureaucrats to compromise, except directly, and that is called bribery, and people go to jail for it. But a tradition of bonuses might help, and it pays off now anyway.)

An extremely effective means of non-wage competition is to drop a thousand dollars in a secretary's lap and tell her to go out and spend it on the office. Tell her she can do anything she wants with it: new furniture, tape recorded music, new filing cabinets, a new electronic typewriter, or whatever. Make it clear that it is for her benefit. What will make the office more pleasant for her? Your competitor who may want her services has not designed an office around her needs.

An intelligent manager will discuss the state-of-the-office with his best clerical and secretarial help. Long-term employees may know when a crisis is brewing, since they spend time unraveling them on a day-to-day basis. Tell your best secretary to cure it. Delegate responsibility. Get the problem out of your hair and hers.

The Family

No matter how liberated women may become, the influence of their families will be felt. Women may choose to remain employed in spite of protests from their husbands, and a manager's costs calculation must include a compensating remuneration. Under price and wage controls, there will be a tendency for women to return to direct family service. There are several good reasons for this. First, child-care services will begin to dry up—or at least those that are not black

market, cash-in-hand services. But the employer is not allowed to increase secretarial or clerical salaries. Thus, some women will have to drop out of the labor force. Second, the wage may not seem so important to the family, since shortages in the supermarkets will reduce the efficiency of money wages. Shortages actually place a premium on other assets, most notably time. Standing in line is one important asset. Getting to half-empty shops before the line gets too long is another. Searching the classified ads, going to garage sales, attending auctions—where prices for used goods are uncontrolled—are all time-consuming alternatives to employment in the labor force. *Shortages therefore subsidize those with access to time.* This is another reason why baby sitting jobs will look less attractive. As baby sitters quit, child care will become more expensive. Thus, your secretary will have an incentive to enter the *time markets* and leave the wage market if she has young children. Managers must take action to prevent this.

The pressures from her husband to quit her job will be intensified if she comes home tired and irritable. (Who wants to be married to someone who continually acts like the people in the "before" segment of a "Valium" commercial?) If her job upsets her too much, she may begin to take it out of his hide. One way to prevent this is to insist that she get out of the office at closing time. She must be informed of her importance continually. A successful manager must let his secretaries know that their families should come first, not the office. Men may be married to the job, but lower-echelon women are married to men. Sooner or later, the manager who cannot admit this risks disaster: her home really will come first. She quits.

It would be wise to find out the likes and dislikes of the husbands of key secretaries. It would be wise even to court them. Tickets to sports events are very useful in this regard. Have "all-husband outings" at the firm's expense. Tickets can also be given directly to the wife to take home to her husband (and sons). Such a donation should be made in terms of the argument that "An associate gave me these tickets, but I can't use them this time." Husbands will believe that executives probably do have access to tickets that they really are unable to use. This is the best kind of gift for someone who is not a friend: something useful to the recipient which does not appear to be a loss to the giver. Envy does not breed in such circumstances. This is not seen as a bribe or something demeaning. If anything, it reminds the husband that the executive remembered that he (the

husband) likes this sport or could use the tickets to take his sons. The tickets need not be the best; if anything they ought to be cheaper seats. No use reminding the husband that he could never afford to buy such expensive seats. Envy is a killer. Take steps to avoid its effects.

Anything that an executive can do for an employee's children is doubly or quadrupally rewarded in good will. Help in school, tutoring, scholarship recommendations, or anything else an employer can do to create excellent labor relations, but more important, such assistance is an excellent form of non-monetary, non-taxable income. Furthermore, most of us will accept gifts from non-family members to our children, even if we would be suspicious of gifts to ourselves. This is especially true of immigrants with "Old Country" backgrounds. The family is primary.

Loyalty

Western laborers, time and time again, have demonstrated their preference for the "cash nexus" system of capitalism, despite the cries of horror from traditionalists, rural elites, and Marxists. If you want to summarize the dialectic of economic history, you can come close in two words: *money talks*. But when money is debased, and the bureaucrats will not allow more than a whisper, then the older means of binding men's labor services comes into the foreground: loyalty. It is a feudal virtue, and in "Western" nations, i.e., industrial societies, only Japan seems to operate in terms of it. Even in Japan, the old system is slowly slipping. Therefore, since price controls will eventually produce what I call the feudalization of the economy, it is best to have a corporate tradition of company loyalty instilled in the employees.

Obviously, loyalty is not created overnight as a managerial response to controls. This is why managers have to begin building institutional loyalty immediately. Small firms have at least this potential advantage over large ones in periods of controls, simply because it is easier for personal bonds to develop inside small production units. An espirit d'corps is not some nice extra that a company may wish to cultivate; it is an economic imperative, given the likelihood of price and wage controls.

The economy of feudalism would substitute personalism and localism for impersonalism and internationalism in the realm of economic exchange. Personal relationships and personal conflicts are

all-important in a collapsing market economy. In a price control economy, contacts count for more than contracts. Who you know becomes more important than money exchange. There is a kind of "loyalty account book" in a feudal economy; he who does not have one is in bad shape. A man can buy loyalty, but the currency used in the purchase will not be exclusively paper. It will be a tradition of concern for the total welfare of the employees, including their families. The corporate executive who recognizes this early enough will have a competitive advantage.[2]

Conclusion

All of this advice may sound trite—textbook knowledge, Dale Carnegie stuff. That it is. The problem with most of us is that we never apply all those trite, elementary sayings that we all acknowledge. Just because something is trite does not mean that it is not difficult. The Golden Rule has become trite through pseudo-familiarity; nevertheless, it is still valid in principle and practice. So it is with good management-labor relations. But in a shortage economy, that which today appears trite will become essential for survival. We must learn to think in non-monetary terms.

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2. See R. C. Sproul, *Stronger Than Steel: The Wayne Alderson Story* (New York: Harper & Row, 1979).

14

EVADING THE EFFECTS OF PRICE CONTROLS: CASE STUDIES

The experience of Germany [1933-48] demands that we consider a little more closely this peculiar policy of repressed inflation. As we have seen, it consists, fundamentally, in the fact that a government first promotes inflation but then seeks to interdict its influence on prices and rates of exchange by imposing the now familiar wartime devices of rationing and fixed prices, together with the requisite enforcement measures. As inflationary pressures force up prices, costs, and exchange rates, the ever more comprehensive and elaborate apparatus of the command economy seeks to repress this upward movement with the counter-measures of the police state . . . The prolongation of a policy of repressed inflation means that all economic values become increasingly fictitious, and this in a twofold sense: (1) state values correspond less and less to actual scarcity relationships and (2) fewer and fewer transactions are completed on the basis on such values. The distortion of all value relations which accompany the division of the economy into "official" and "black" markets, and the struggle between the directives of the market and those of the administrative authorities finally lead to chaos, to a situation in which any kind of order, whether of the collectivist or the market economy type, is lacking.

Wilhelm Röpke[1]

It was not only Germany which experienced the effects of price and wage controls coupled with monetary expansion—repressed inflation—but the entire Western world. Germany, however, was the first European state to adopt the policies of repressed inflation as

1. Wilhelm Röpke, *Economics of a Free Society* (Chicago: Regnery, 1963), p. 104.

a peacetime measure of the 1930s.[2] And the Allies virtually sanctioned Germany's domestic economic policies by imposing "victors' justice" on the defeated German nation: maintaining the price controls policies imposed by Hitler's Nazi government.[3] All that can be said in favor of the Allies' program is that it gave Ludwig Erhard, Röpke's former student, the opportunity to throw off this "foreign" system in June of 1948, at least in the British and American zones. It was a strong political argument among Germans at the time, and without the decontrol of the German economy in 1948, there would have been no "German miracle." (It was also an acceptable political argument—national self-determination—with the Allies, except for the Soviet Union. But the Soviets had withdrawn from the 4-power Allied Council in March. Erhard's decision allowed the Allies to come to an agreement about the abolition of controls, without having France, England, or the U.S. propose and therefore take responsibility for the program.)[4]

Who Wins? Who Loses?

Röpke's point is well taken: the official prices are fictitious. Fewer transactions, proportionate to total transactions, take place at the official prices. Prices are not controlled by the authorities, for that is not possible; only visible monetary prices are controlled. Even more accurately, those people who are forced to sell at official monetary prices and those who would be willing to buy at higher prices, but who cannot locate legal sellers, are controlled.

Price controls therefore involve a redistribution of wealth. Why? First, some people are compelled to sell at prices lower than they would otherwise have preferred to receive and would have been able to receive. The beneficiaries are, of course, the buyers. The intended beneficiary is the "little guy." The actual beneficiaries—legal

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2. Guenter Reiman, *The Vampire Economy: Doing Business Under Fascism* (New York: Vanguard Press, 1939). Amazingly, there is no definitive scholarly study of the fascist economies of the 1930s, despite an endless stream of doctoral dissertations and useless monographs on forgotten and forgettable economic history topics.

3. Nicholas Balabkins, *Germany Under Direct Controls: Economic Aspects of Industrial Disarmament, 1945-1948* (New Brunswick, New Jersey: Rutgers University Press, 1964).

4. Heinz Sauermann, "The Consequences of the Currency Reform in Western Germany," *Review of Politics,* XII (April, 1951), p. 179. This article is typical of the Keynesian response to the reform: skepticism because of the reform's "deflationary" consequences: pp. 195-96.

beneficiaries—are the Federal government, the higher officials in various governments, and those people who are willing and able to stand in long lines for many hours (and whose alternative uses of their time are, in their own estimation, less valuable than the goods they receive). Second, wealth is transferred to those who produce goods and services favored by the government, or those who produce goods produced in the uncontrolled segments of the economy ("luxuries"), assuming that these producers would not have prospered so well under conditions of open competition and free pricing. The losers are, of course, producers who would have profited under the free market and those consumers who would have bought from them. Third, wealth is transferred to those who have fewer moral qualms or fears about participating on the illegal markets, since available goods and services tend to flow in the direction of these markets. The larger the discrepancy between the legal monetary price of a good and the monetary inflation-induced illegal market price, the more goods are transferred to the alternative markets. The losers are the morally inhibited, or fear-inhibited, or information-lacking, or barterable resource-lacking citizens. Above all, the losers are the propaganda-manipulated patriotic citizens. Under all price control schemes, this law rules: *cynics win, patriots lose.* That is the curse of the government-controlled prices. Fourth, repairmen win. Fifth, those who own goods win, since used goods are not controlled. In short, those who possess the real money or monies win: good looks, power, goods, inside information, barterable skills, cynicism, and so forth.

Economically speaking, price controls serve as a subsidy to the cynics. They subsidize those who would not have fared so well under the free market. They are anti-market devices, and they favor anti-market groups and those who do not prosper under conditions of peaceful competition, such as the Mafia. Those who do not wish to subsidize the anti-market elements of the population should not call for price controls unless they believe that the benefits of a controls-induced redistribution of wealth somehow outweigh the costs. (The theoretical problem here, however, is that there is no way of measuring costs and benefits outside of a free market, or at least no strictly economic way of making such an evaluation.)

Results of a 1976 Readers' Survey

Years ago, I learned that one of the best sources of information

available to me is my own subscriber list. I serve as a kind of middleman between *Remnant Review* subscribers. If I ask the right questions, they can learn a lot from each other. In 1976, I sent out a readers' survey sheet to subscribers asking them to provide stories of their experiences under price controls. I received some fascinating replies, which I am reporting in this chapter. There are theoretical reasons for concluding that similar policies will produce similar results, so our questions must center on the specifics of the legislation.

The experience of controls in the Nixon years may lead future price control bureaucrats to conclude that next time they will have to set limits on the prices of raw agricultural and mineral products. This, in turn, will necessitate prohibitions on the export of raw materials that are under the controls. We saw this in June and July of 1973. John O'Donnell reports, "Nixon froze silver prices at $2.35/oz. in the U.S. This created a black market in all gold and silver coins plus bullion scrap, i.e., scrap X-ray film and photographic sludge. U.S. refiners would not increase buying prices at spot [cash] markets, while futures [contracts to buy or sell products in the future] prices increased to $2.85/oz. We shipped our bullion and scrap into Canada (Toronto) to receive full value at $2.85 per troy ounce. Most major U.S. refiners have offices in Toronto. The net effect is a silver shortage. . . . When price controls were lifted, silver prices stabilized at fair market value closer to $2.56/oz." A similar crisis was created in soybean production. Farmers have always exported soybeans to Japan — the major buyer of soybeans, including U.S. soybeans, world-wide. So the government banned the export of soybeans in 1973. Why? To lower the price of soybeans domestically. And who consumes most of our soybeans in this country? Dogs. Soybeans are a high protein meat substitute in pet foods. We harmed a major ally to save money on dog food. So we wound up selling wheat to the U.S.S.R. at low 1972 prices, thereby fulfilling our contracts — contracts hammered out primarily by U.S. government officials, not U.S. farmers — and embargoing soybeans, a major export to a major ally. So much for the policies of Henry Kissinger, Earl Butz, and John Dunlop.

The shortage problems people faced in World War II were varied, predictably, depending upon the geographical location involved. Frederic A. reports: "Price controls did not have as large a dislocative impact on our rural life as it may have had on urban-dwellers. Most everything that was in short supply became a 'rationed'

item. Our economy was as much favor-regulated as it was price-regulated. Consequently, scarce (rationed) items such as meat, sugar, coffee, gasoline, tires, and batteries were items for swapping among acquaintances. From time to time we would hear of black markets selling sugar and meat at prices 2 or 3 times the grocery store price. Perhaps the item whose shortage most curtailed our normal living was the gasoline shortage. To cope with this, Dad secured both the regular 'A' category of gas rationing coupon and also the 'C' category (perhaps because he was entitled to it as a minister). Anyway, when gasoline ran low, Dad would somehow persuade a friendly farmer to direct the hose of his 200 gallon farm vehicle tank into our gas tank and into miscellaneous gas cans in the truck." (This "farmer-supplied fuel" scheme is operating today in the case of diesel fuel, since "farm only" diesel fuel is tax free.)

Even more devious, however, was the scheme related by S. E. Barber: "In the area of gasoline rationing I can't remember all the details, but the various categories for civilian use were 'A, B, C' (stamps worth 3-5 gallons each) for autos, 'K' stamps for trucks, 'J' for utility, etc. The dodge lay in (1) plant a 'victory garden' (officially sanctioned by Fed. Gov.); (2) buy some form of power equipment (rototiller, small tractor, etc.)—even if it doesn't run, you've still got a model number and serial number—and apply at the local ration board for gas stamps to run the thing. Garden by hand and use the 'J' stamp gas in your car." (On the next page, a reproduction appears of several of Mr. Barber's mother's ration stamp books. Younger readers should not feel sad that they never owned such wonderful items. Have patience. They're coming.)

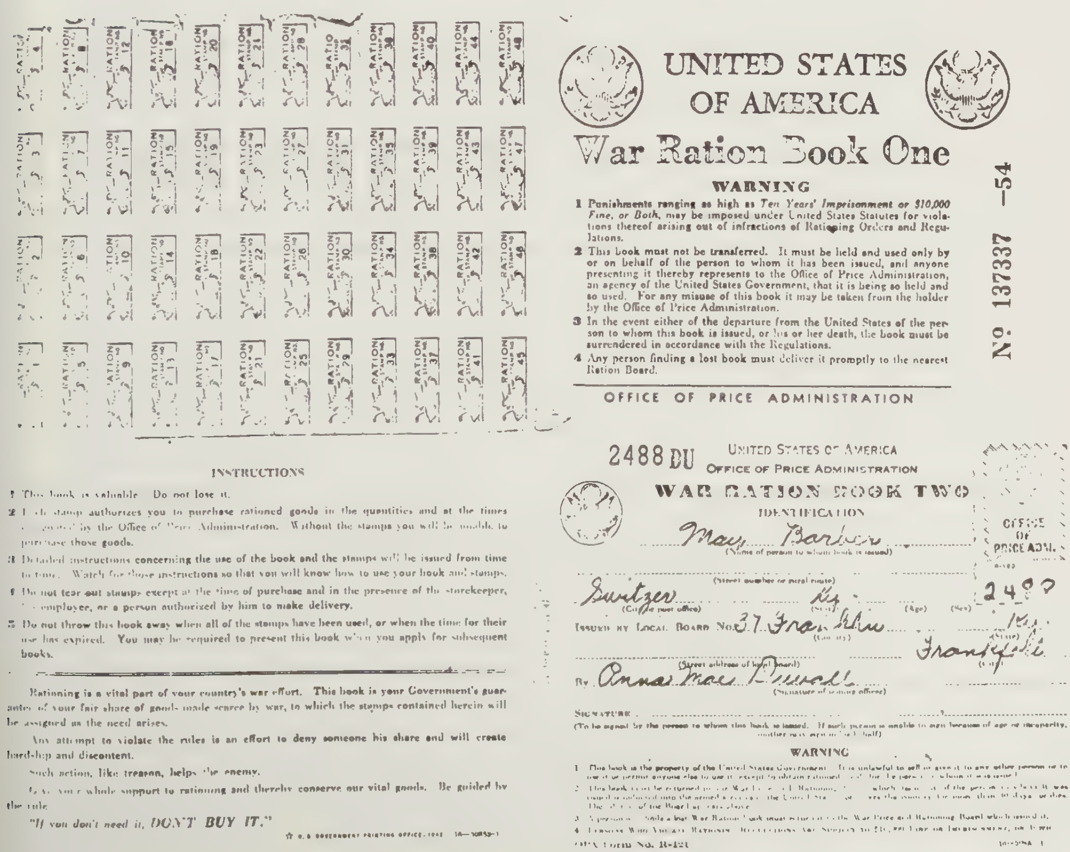
Thurman Alderman reports on a tactic used by a friend of his during World War II to get gasoline. His friend was a piano tuner, which had no priority allocation. He took a job at an aircraft plant. He was rationed enough gas for six round trips per week, about 200 miles. Then he joined a car pool, so he only drove once a week. The left-over gasoline—enough for 170 miles—was then used in his moonlighting job as a piano tuner, a job which he kept throughout the War.

One of the most amazing of the gasoline stories reported by my readers came from H. H. Bresee. I think some chemist ought to pursue this one:

> One day I went to buy some oil from a friend of mine who owned a rerefined oil company. He collected crank case oil and ran it through a still to get the

oil (it was good oil). While there, they were running off material removed from the oil (they called it "puke"). It looked like gas mostly. I put 5 gallons in my Model A Ford, and it ran pretty well but made a lot of smoke. The chemist said this smoke was caused by the sulphur and phosphorus in the "puke." He fixed up enough chemicals for a 50-gallon drum, put in a shovel full of clay that they used, stirred it up, and let it settle. The result was a clear golden gas that ran swell in the Model A and with only a slight knock in my Pontiac. We had all the gas we could use. I gave my stamps to my friends, as well as a 5-gallon can of gas every now and then, and it didn't cost anything either, except to go over to the refining company and pick up the gas.

The car to own, should this be repeated, would be a Mazda rotary. Wankel rotary engines run beautifully on the lowest octane gas available—down to 70 octane.



UNITED STATES OF AMERICA

War Ration Book One

WARNING

1 **Punishments ranging as high as** ***Ten Years' Imprisonment or $10,000 Fine, or Both,*** may be imposed under United States Statutes for violations thereof arising out of infractions of Rationing Orders and Regulations.

2 This book must not be transferred. It must be held and used only by or on behalf of the person to whom it has been issued, and anyone presenting it thereby represents to the Office of Price Administration, an agency of the United States Government, that it is being so held and so used. For any misuse of this book it may be taken from the holder by the Office of Price Administration.

3 In the event either of the departure from the United States of the person to whom this book is issued, or his or her death, the book must be surrendered in accordance with the Regulations.

4 Any person finding a lost book must deliver it promptly to the nearest Ration Board.

OFFICE OF PRICE ADMINISTRATION

Nº 137337 –54

INSTRUCTIONS

1 This book is valuable. Do not lose it.

2 Each stamp authorizes you to purchase rationed goods in the quantities and at the times designated by the Office of Price Administration. Without the stamps you will be unable to purchase those goods.

3 Detailed instructions concerning the use of the book and the stamps will be issued from time to time. Watch for those instructions so that you will know how to use your book and stamps.

4 Do not tear out stamps except at the time of purchase and in the presence of the storekeeper, his employee, or a person authorized by him to make delivery.

5 Do not throw this book away when all of the stamps have been used, or when the time for their use has expired. You may be required to present this book when you apply for subsequent books.

Rationing is a vital part of your country's war effort. This book is your Government's guarantee of your fair share of goods made scarce by war, to which the stamps contained herein will be assigned as the need arises.

Any attempt to violate the rules is an effort to deny someone his share and will create hardship and discontent.

Such action, like treason, helps the enemy.

Give your whole support to rationing and thereby conserve our vital goods. Be guided by the rule:

"If you don't need it, DON'T BUY IT."

U. S. GOVERNMENT PRINTING OFFICE 1942 16—30853-1

2488 DU UNITED STATES OF AMERICA

OFFICE OF PRICE ADMINISTRATION

WAR RATION BOOK TWO

IDENTIFICATION

May Barber
(Name of person to whom book is issued)

(Street number or rural route)

Switzer Ky. 2497
(City or post office) (State) (Age) (Sex)

Issued by Local Board No. 37 Franklin Ky.
(County) (State)

Frankfort
(Street address of local board) (City)

By Anna Mae Powell
(Signature of issuing officer)

Signature
(To be signed by the person to whom this book is issued. If such person is unable to sign because of age or incapacity, another may sign in his behalf)

OFFICE OF PRICE ADM.

WARNING

1 This book is the property of the United States Government. It is unlawful to sell or give it to any other person or to use it or permit anyone else to use it, except to obtain rationed goods for the person to whom it was issued.

2 [illegible]

3 A person who finds a lost War Ration Book must return it to the War Price and Rationing Board which issued it.

4 Persons Who Violate Rationing Regulations Are Subject to $10,000 Fine or Imprisonment, or Both.

OPA Form No. R-121

Another way used to beat any price control scheme is to reduce product quality. For example, oil companies reduced octane in their gasoline during the 1974 OPEC embargo-price control period. This was made illegal when the government found out, but these discoveries take time. Meanwhile. . . . One anonymous expert in the field of hides (of animals, but also voters) reports: "During WWII to Korea, leather gradings (normally 1, 2, or 3; or A, B, C) all became #1 or A. Also, lower grade leather was put into high category lines and price categories. Also hides did not yield the same—higher moisture, salt, manure content. Again, the #3's became #1's." Bill Bowers reports that municipal services in his small Kansas town declined steadily during the war. This is a common feature of both wartime and peacetime price control periods; current operations are financed out of capital expenditures, and total per capita investment declines. This eventually leads to reduced output and reduced wealth.

Building materials are always a problem under controls. Marshall Tilden's comments are especially revealing; where there is a will, you may get away: "As a general contractor primarily building custom homes, I experienced serious difficulties in obtaining metal building products at any price. Several contractors got together at a luncheon and decided to have a bi-monthly meeting for the purpose of exchanging ideas to circumvent price controls and keep in business. One of the methods was to bid government jobs in order to obtain priorities for materials. We usually were able to buy under priority more material than was actually required for each priority job. Each of us stockpiled all critical material we were able to purchase through any source and then we used these stockpiles for exchange. I had a salesman travel through the Midwest states buying stucco netting from material suppliers a roll at a time. These rolls were accumulated and then shipped to me. The same way with nails. These materials were used for trading purposes and kept me in business. In some cases we were paid double the control price. The fact that I was buying for more projects under priority made this possible." In short, *priority slips* served as *the real money supply* in the construction industry.

As soon as the war began, automobile construction was brought to a screeching halt. Anyone who had real foresight and a bit of cash on Dec. 8, 1941, would have been wise to go down and order a new car, or late-model used car, plus several sets of tires, spark plugs, points,

condensers, oil, and so forth. Even if he had been forced to mortgage his home to get down-payment money, it would have been a smart move. But for sheer entrepreneurship, nothing beats this anonymous reply: "Anticipating difficulty in obtaining a new automobile after the end of active hostilities, I made an interest-free cash deposit with a local dealer permitting him to use my funds in return for priority delivery of a car. This agreement was honored with complete satisfaction after about two years with no further inducement on my part." He was less successful in this same arrangement with another car dealer who later refused to place him high on the priority list. He thinks in retrospect that a lawyer should have been brought in to set up the original agreement. "In the end, the reliability of the dealer was more important than the money or the car." He refers to his second agreement, in which he had traded in his 1942 Plymouth as an initial deposit. This, it seems to me, was a less than thoughtful move. First, 1942 cars were bound to become collectors' items. Second, giving up a new scarce resource for a hoped-for future scarce resource is extremely risky, especially during wartime, when the duration of the war is in question. He concludes: "I believe this system will work with any major appliance or equipment, but one should take care to contract only with financially sound and established firms who may be expected to continue in business and value their reputations for fair dealing in the community." This sounds good, but firms that take paper money when price controls are on are not being managed by very rational people, unless the dealer himself is presently very active on the black markets and the money still functions on those markets to some degree. Under today's conditions of massive deficits, price-inflation expectations, monetary expansion, and a high division of labor (meaning extreme personal vulnerability to shortages), the man who accepts paper money for hard goods is likely to go bankrupt before he can deliver, or else he may be dishonest. Winning the Second World War was one thing; winning the war against envy-produced socialism should take a lot longer.

People living on a national border may have a distinct advantage, assuming price controls are not already in effect across the border and assuming that currency controls are only loosely or ineffectively enforced. Writes Mrs. A. C. Reed: "Nothing was a hardship for us, primarily due to our access to Mexico. Nothing was rationed there, so the residents of south Texas towns went across the border for gas,

sugar, meat, shoes—anything we needed. As a matter of fact, sugar is still 6 cents to 12 cents per pound there, while ours is about 4-5 times that amount." The reason for the modern sugar price discrepancy is that the U.S. has rigid sugar import quotas to protect domestic sugar manufacturers and also to produce incomparable bribe opportunities for those who are connected with the establishment of the annual import quota formulas. ("Latin American sugar exporters are to U.S. officials as Lockheed 'expediters' were to. . . ." Fill in the blank and send your answer to Prince Bernhard, Bilderbergers Co., Netherlands.)

Rev. R. J. Rushdoony, then a missionary to the Western Shoshone Indians in the Elko, Nevada area, offers this assessment: "During the war years, I found that I was able to get everything I wanted, without any resort to the black market, when I wanted. Only once was I delayed about a month in securing a new tire. I drove to and from California and Nevada for church meetings, and never had trouble securing extra gas coupons legally, or tires. My principle was a simple and Biblical one: do unto others as you would have them do unto you. On the whole, it paid off handsomely. I traded with people, irrespective of price, if I felt they were good and trustworthy businessmen. My shipping or buying was exclusive. As a result of my loyalty, I received loyalty. People went to bat for me to enable me to get what I wanted when I needed it. . . . My loyalty to various retailers was religiously, not pragmatically, principled, and it was appreciated. In brief, what I am saying is that economics is more than economics: it involves people, friendships, loyalties, and a variety of non-economic considerations. It is the economic fallacy to view anything, such as economics, in purely economic terms. Life is unity. Because I was not thinking of tires or gas first, or my slight economic advantage with another merchant, but had a unified motivation which made economics subordinate to a unified principle of life, I came out far ahead. This principle works in both war and peace, in time of rationing, and in times of plenty."

Conclusion

Applied economics has got to be more than applied econometrics, applied indifference curves, or applied utility theory. Bringing down rarified academic models or "ideal types" into the real world necessarily immerses the graphs, charts, and abstract chains of reasoning in a universe in which other things never remain equal. Those

"other things"—loyalty, principled action, commitment to goals that are higher than profit and loss in a double-entry record book—can be the difference between hardship or leisure, alms-taking or alms-giving.

Yet at the same time, ethics—applied moral principle—cannot ignore the realm of economic theory if it is to stay practical. An impractical ethics is as impotent as an immoral economics. Thus, those who intend to achieve certain ethical goals need resources in a world of scarcity. And the world of price controls is a world of government-induced scarcities on a massive scale. Men need information. The fusion between a reliable ethical position and reliable economic analysis is what Christian economics is all about. If we are going to lead, we need economic resources. If we want economic resources, we need to understand the effects of price controls and the best ways around them. Some people win and most people lose under a system of controls. We should be the ones to win, not for the sake of oppression, but for the sake of reconstruction.

15

THE INEVITABLE BREAKDOWN OF THE CONTROLS

There are reports of widespread disregard and violation of the price-control law. Experience shows that this leads to a tendency to disregard the sanctity of other laws of our country. I need not point out the danger of such a public attitude.

Pres. Harry S. Truman
speech announcing the
termination of price
controls (Oct. 14, 1946)

Thus ended another social and economic experiment inflicted on the American public by the great experimenter himself, F. D. Roosevelt. Naturally, it ended in failure. Five and a half years before, on April 11, 1941, Roosevelt had created, by executive order, the Office of Price Administration and Civilian Supply (OPACS), the forerunner to the Office of Price Administration (OPA), which Roosevelt set up by executive order on August 28, 1941. Pearl Harbor, you may recall, was not hit by the Japanese until Dec. 7, 1941. Roosevelt hit the country with a wartime price controls bureaucracy before the Japanese dropped their bombs. The controls were to stay on the books until 14 months after we dropped the two atomic bombs on Japan.

Truman gave his stirring speech in favor of decontrol in direct response to an overwhelmingly unsuccessful strike on the part of cattlemen who refused to send their beef to the official markets. They forced Truman's hand. Prior to his capitulation, those in the control bureaucracy had painted a rosy picture of how successful the wage-controlled transition to the peacetime economy would be.[1] Truman

1. See the essay by Harry Henig and Herbert Unterberger, two officials with the

was quite willing to slap on price controls during the Korean War, indicating that he didn't believe his own rhetoric. Richard Nixon repeated this performance when he slapped on price controls by administrative decree on August 15, 1971, despite his earlier assurances that controls are bad, controls don't work, etc. He knew from experience, he said; he had begun his career as an obscure official in the OPA.

The lessons of the price controls of the Second World War are still useful, for the effects of price controls are everywhere quite similar. Truman was correct; the widespread violations of the controls did lead (and will always lead) to skepticism about the validity of the law. Milton Friedman commented on the phenomenon of public trust and law enforcement in a brilliant and completely neglected essay that appeared in the Summer, 1962 issue of the now-defunct *New Individualist Review.* Governments always rely on the willingness of individual citizens to employ self-restraint; no law enforcement system can employ sufficient resources to enforce the law on a recalcitrant population. Self-restraint, local sanctions like ostracism and censure, and private institutions like churches and schools must co-operate with public law agencies. Without such co-operation, there is no respect for the law, and society disintegrates. But legislators and bureaucrats tend to misuse this store of public trust. They pass law after law, thereby disrupting the daily lives of all citizens. The public begins to lose confidence in their public leaders. They begin to resist the laws by evasion. The legal capital available to politicians and bureaucrats—voluntary self-restraint on the part of citizens—begins to run out. The politicians refuse to use self-restraint in their legislative activities, and the loss of restraint escalates. The law enforcement agencies cannot hope to compete with a growing army of citizens who refuse to co-operate. Either politicians turn back and rid the society of their own legal baggage (for example, England in the 1840s), or else the whole jerry-built structure of laws collapses. Only outright tyranny—a tyranny that acknowledges the necessity of at least some lawbreakers who supply the needed goods and services through their illegal activities—can hope to subdue the voluntary actions of men, once those men have

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Wage Stabilization Division of the National War Labor Board, "Wage Control in Wartime and Transition," *The American Economic Review,* XXXV (June, 1945). See also a series of essays on "Price Control and Rationing in the War-Peace Transition," *ibid.,* XXXV (May, 1945), pp. 150-92.

lost confidence in the legitimacy of public law.[2]

This is precisely what has happened throughout history when politicians have attempted to impose price and wage controls. Controls cannot last.[3] In the meantime, however, they can literally destroy those who attempt to abide by them. They can create a sense of guilt among those who initially try to abide by these insane laws and then give up and violate the statutes. They are bad laws, and they lead to bad results. The first step in learning how to cope with price controls is to realize that they are immoral, unworkable, and ultimately doomed. They do not deserve respect. They will not long maintain respect, at least not as far as compliance among the broad population is concerned, no matter what citizens tell public opinion pollsters.

World War II Controls: The United States

Price and wage controls are as common to modern warfare as the draft.[4] They do not work in wartime, either. Controls are based on economic ignorance and envy. I am not sure which factor is more important, but both operate in the minds of controllers and the controlled. *Ignorance* leads men to believe that an official price ceiling that is lower than the market price of a good will not reduce the supply of that good, while simultaneously increasing demand for it at the artificially low price. In short, shortages are the inevitable effect of controls—a shortage of goods in comparison with demand. This demand can be registered in numerous ways, such as a willingness to pay illegally high prices or a willingness to stand in long lines, but the artificially low legal price will draw people to the shops and shelves where they think the goods will be available. Seldom will the

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2. The complete set of the *New Individualist Review* has been made available in book form by Liberty Press, 7440 N. Shadeland, Indianapolis, IN 46250.

3. Robert Schuettinger and Eamonn Butler, *Forty Centuries of Wage and Price Controls* (Washington, D. C.: Heritage Foundation, 1979). Address: 513 "C" St., N. E., Washington, D. C. 20002. Summaries of Schuettinger's book are found in his essays, "The Historical Record," in *The Illusion of Wage and Price Control,* edited by Michael Walker (Vancouver, British Columbia: Fraser Institute, 1976). Address: 626 Bute St., Vancouver, B. C., Canada V6E 3M1, and "Four Thousand Years of Wage and Price Controls," *Policy Review* (Summer, 1978), a publication of the Heritage Foundation.

4. For a description of wartime controls, see Edwin B. George and Robert J. Landry, "The Problem of Controling Resource Flows in Wartime," *The American Economic Review,* XL (June, 1950), a review essay on David Novick, *et al., Wartime Production Controls* (New York: Columbia University Press, 1949).

disgruntled buyers, or potential buyers at the low price, grasp the fact that the artificially low prices set by bureaucrats have led them to make errors in estimating available supplies. Instead, they call for more controls, or enforcement procedures, so long as it is the other guy who is controlled. This brings us to *envy:* the desire to bring down the other guy. If someone is profiting from the war, he should be stopped. After all, aren't our boys dying overseas? Yes they are; and if controls are enforced, and profit ceilings are imposed, producers who could produce better weapons, cheaper weapons, and more weapons will have far less incentive to produce them, thereby keeping the death figures higher for our side. But this sequence of events is not understood, which gets us back to the ignorance component of the support for price controls. So support grows for controls, even as individuals do their best to evade them.

Controls are most enforceable during wars. Self-restraint is greater, men are willing to eat up their capital in order to keep the war machine going, more citizens are willing to serve as unpaid informers (500,000 "volunteers" during WWII, though only 275,000 at one time, the peak period), and more price controllers are employed. Yet the war years demonstrated how very willing Americans were to violate controls that involved hardships. When the pinch was on, they evaded the controls. And the pinch was on.[5]

Gasoline Rationing

Gasoline rationing was the biggest bureaucratic problem for the OPA. There were too many cheaters. Everyone knew there were ample supplies of gasoline (the controls had been imposed to reduce the consumption of rubber by tire users), and Americans, then as now, wanted to use their cars. The OPA bureaucrats tried to give some groups special treatment because of their special needs (ministers and physicians), but everyone wanted preferential treatment some of the time. So the evaders went to work. First, there were millions and millions of *counterfeits.* The ration coupons were really money, so they were treated as such by private printers. The "money" was less familiar to gas station attendants, so they could be passed fairly easily. But the gas station owners became buyers of counterfeits. They would sell gasoline to buyers who didn't have

5. J. P. Cavin, "Aspects of Wartime Consumption," *The American Economic Review,* XXXV (May, 1945).

ration coupons; then the station owners would turn in the counterfeits that they had bought. If they were caught (which was seldom until after the war), they could always plead ignorance. "Some shady gasoline buyers just fooled me, your honor." Chester Bowles testified before Congress that the profits were a billion dollars a month in 1944 (I think Chet's days as a bit-time advertising man may have gotten the better of him). Profits were there, certainly, and the risks really were minimal. While surveys of stations by OPA enforcers indicated that 60% of them were participating to some extent in illegal sales, only 15,094 sanctions were imposed throughout the war. Yet there had been 150,000 stations in 1941. Only 3,500 of these were actually brought to court under criminal sanctions. In 1944, there were 124,000 cases revealing violations; sanctions were imposed in 8,700 cases. Risk? Not much. And everyone knew it.

There were other forms of gasoline evasion, however. Counterfeit coupons were only part of the story. Station owners mixed regular gas with premium. (Reduced quality is a traditional means of evasion for most goods and services.) Buyers were asked to buy repairs or products that were more easily available or even unrationed. There was almost no way to police these violations. The same techniques were used during the 1974 gasoline shortage. In fact, this is always the case: *you can buy something you don't need to get what you do need.* Get all your gas and auto repairs down at your friendly local station; midnight gasoline may be available after the place is officially closed. A Christmas bonus to the station owner is also called for. Your car may run on alcohol after all—Jack Daniels, to be specific.

Investigations conducted by OPA in 1944 of America's large manufacturing and wholesale firms revealed that about 70% of them were in violation of OPA rules. In that same year, 57% of all businesses investigated were in violation. These were not random samples, although part of the totals were sampled randomly, but the very high percentages at the very height of war (and appeals to patriotism) indicate that the control program was a massive failure. Bowles, who headed the agency in 1945, admitted in an OPA memorandum that a major weakness with OPA's public relations efforts was the fact "that so many violations go on unchecked, and that when violations are found the action taken is not strong enough or vigorous enough. I have met this criticism every time I have been

away from Washington, regardless of where I have gone. More and more, the public tends to blame OPA for lack of effective enforcement." The public participated in the alternative ("black") markets, yet cried out against lax enforcement by OPA bureaucrats.

Public attitudes regarding controls are always paradoxical. In November, 1941, a Gallup poll revealed that 64% of those surveyed in cities over 100,000 favored price controls. It was 54% in cities under 100,000 and 46% among farm areas. In 1943, National Opinion Research Center found the figure had climbed to 94% nationally. In 1945, it was up to 97%, and 65% of those surveyed wanted an across-the-board freeze. Yet the whole nation was violating the existing laws daily. In January, 1946, 83% still favored continued controls. In April 1946, NORC found that 85% still favored rent controls, and 52% wanted them for more than a year. And everyone was cheating. There were raids on commercial frozen food lockers, for example. *Business Week* (May 5, 1945) reported that one check of a Chicago meat locker revealed that 87% of the meat in the lockers had been obtained illegally.

Enforcement

Where there are bureaucrats, there will be inefficiency. Local rationing boards were notoriously lax about records, safety, and general procedures. When OPA officials inspected local boards periodically they found some true horror stories—from the OPA's point of view, that is. Frequently, some boards would have 5-10 years' worth of gasoline ration coupons. In some cases, the figures soared to 40, 80, or 90 years' worth. In two cases, inspectors found 137 years' supply of the gasoline coupons. One board had a century's worth stored in an unlocked garage; the wooden cabinet's lock could be picked with a hairpin. At 10 cents per coupon on the black market, the coupons were worth over $950,000—WWII dollars, of course. Thefts were common, and only after the war did the OPA devise fairly successful procedures to deal with gasoline coupon violations of various kinds.

Local boards, understandably, hesitated to impose strong sanctions against local violators of OPA regulations. Decentralization is basic to any bureaucracy that has to police a geographical region as large as the U.S.A., but localism spells favoritism. There were 96 OPA regions, and district directors had remarkable latitude to hire,

fire, and enforce selectively the laws that they agreed with. This means that local friendships, local contacts, and local bribes could postpone or even eliminate the day of judgment for violators.

There wasn't much of an investigation staff in the OPA. In 1941 it was 200; 1942: 900; 1943: 1,800; 1944: 2,800; 1945: 3,100; 1946: 3,600. There were never over 800 lawyers to prosecute violators. Obviously, you can't police a hundred million buyers and sellers with that kind of staff. Even with 500 information officers ("flacks"), the OPA couldn't convince all of these citizens that violators would be inevitably tracked down and prosecuted. Ironically, it was only in late 1945 that a full-scale program of fear was introduced; OPA news releases then concentrated on successful prosecutions. (The Internal Revenue Service uses this same technique.) Furthermore (also like the IRS), the staffers were not the best men in the civil service program. Few applicants for OPA investigating jobs had any kind of experience in the field, since it was a new field. Enforcement attorneys were unfamiliar with this kind of case, and many were hostile to the idea anyway, having been recruited from private industry. The OPA never did overcome this problem, which is one reason why we won the war.

Marshall B. Clinard, who served the OPA faithfully from Dec. 1942 to Sept. 1945 as its Chief, Analysis & Reports Branch, has given us this interesting statistic. The total number of criminal convictions in cases prosecuted by the OPA from 1942 to 1947 was 11,600. This was a 94% "hit ratio" of the 12,415 completed criminal cases. Of these 11,600, only 25%, or 2,970, received prison sentences; 3,318 received suspended sentences or were put on probation. To say that it was safe to violate price controls in the U.S.A. during WWII is not doing the statistics any justice. (Clinard's book, *The Black Market,* provides a good introduction to the whole incredible story of OPA. I have relied on it for these accounts of price control evasion in the 1940s. It was reprinted in 1969 by Patterson Smith Pub., Montclair, New Jersey. It came out first in 1952.)

This does not mean that enforcers will always be equally lax or impotent. But it does mean that bureaucrats are inefficient people who work in inefficient organizations. They cannot hope to police a population that does not believe in what the bureaucrats are trying to accomplish, or what the bureaucrats do accomplish (assuming that the public officially professes faith in the general goals). The history of WWII price controls in the U.S.A. is the history of black

market activity so widespread that it was more a case of white market activity; the phony markets were the OPA-controlled ones. They cannot enforce the unenforceable. The law is a sham. People who realize this will truck and barter on the illegal, private markets. He who believes that the controlled markets are the real markets will suffer the consequences: shortages.

One of the excuses given by Clinard for the failure of OPA is the time factor. The OPA didn't get moving soon enough. It didn't impose strong enough sanctions early enough. If the OPA had been given sufficient staff, sufficient resources, and sufficient funds to employ sufficient numbers of local informers, we are asked to believe, the price controls of WWII would have worked. The controls system was "voluntary" until Feb. 11, 1942. On that day, two momentous events took place: Leon Henderson took over the reigns of OPA as our first official Price Administrator, and I was born, the future unofficial Price Unadministrator.

The Time Lag

The Emergency Price Control Act had been signed into law on January 30, but even before that date, the OPA had begun to ration auto tires. There was a crucial time lag between late December and late January; people still had the ability to go out and buy goods on legal markets. Even after January 30, a few precious days remained for sellers to take legal evasive action and raise prices. But after February 11, prices of key commodities were frozen, and in April all others were frozen. The straight-jacket was in place.

This means that it takes time before the controllers can get the enforcement mechanism rolling. It is in the pre-control period that buyers can take advantage of their freedom and buy whatever they can afford. Then come controls. There are always several weeks, at least, to buy goods that are still on the shelves. In fact, for some goods there may be many months, especially in less populated regions where supplies are not being monitored closely, and local people do not understand the threat of shortages. Urban dwellers learn far sooner, since they are more closely watched by bureaucrats and, more importantly, they are more completely dependent upon goods that are brought into the city daily and sold for money at money prices. General controls are felt in the cities first.

Anyone who thinks that controls are likely to be reimposed should remember WWII: there were several weeks when free market prices

still were related to existing supplies and existing demand. The wise buyer took advantage of that brief period of rational prices. A man can buy at many stores in order to maintain invisibility. In fact, buying in a community 50 miles down the road would be wise. Local people do not know what is in your basement or attic when you have purchased goods out of town. Once controls are announced, it would be wise to take a vacation, or even annual sick leave, to spend time buying hard goods. This might even mean getting a loan at the bank. It might even mean refinancing the house. Debt is unwise, but in emergencies it can be used to provide necessities. Swift action is critical during the first month of price controls. I cannot emphasize this strongly enough. Let January, 1942 teach us well.

World War II Controls: Holland

There is no such thing as a "hard money" book that does not recommend the purchase of gold and silver coins as inflation hedges. These are the very definition of hard money. But this faith in pieces of metal can be misplaced. The precious metals have their uses in a barter economy, but in a major crisis, their value is severely limited.

One of the most revealing discussions of this point appeared in *The Los Angeles Times* (April 27, 1980): "What Matters the Price of Gold?" The author, Lola Gillebaard, described events that took place during World War II.

Her husband's parents had been married in 1920. His mother gave his father a wedding present, a family legacy. It was a gold watch sprinkled with diamonds and rubies, made in 1790. It even had a chime. When the Germans occupied Holland, they imposed food rationing. The family lived in Amsterdam.

> In September of '44, the Allied air invasion of Arnhem cut off the Dutch industrial west, the most densely populated portion of Holland. The resulting food rations for the Gillebaard family of seven were: two pounds of sugar beets, two pounds of potatoes and one loaf of bread (per week per person). Dutch guilders bought the rationed food and paid the rent. For any other purchase, inflation made money almost worthless. My husband, Hank, was 17 years old then. He weighed 85 pounds. Mama's sugar beet potato soup was mostly water by the middle of the week.
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> One night after sending the children to bed hungry, Mama slipped something into Papa's pocket. Papa protested. Mama insisted. The next morning Papa swapped Mama's diamond bracelet on the black market for a goat, supposedly a milk goat.

As it turned out, it was a billy goat. The family had no knowledge of goats. So they wound up slaughtering it. Half the carcass went to the butcher. So they had bought half a goat for a diamond bracelet.

By February of 1945 the goat was remembered as a smorgasbord. The food rations had dwindled to half a loaf of bread and two potatoes per person per week. Mama supplemented the family diet with tulip bulbs whenever she was lucky enough to find them. The weather was freezing, there was no wood or coal to burn, and the Gillebaards, like most Dutch people, were slowly starving.

One Sunday afterooon, Papa and one of his employees bicycled to the farmland outside the city of Amsterdam. They pedaled on bicycle rims. All rubber had been confiscated many months before. Those two knocked on the door of every farm house. They asked each farmer if he had any food to sell. Papa revealed his antique gold watch, which he now must trade for nourishment. Each farmer examined the watch and listened to the chimes. Then he shook his head, gave the watch back, and said, "I've got gold coming out of my ears." With that he slammed the door.

Papa and his employee turned up their coat collars against the wind and continued to cycle. And then they found a farmer who looked at the watch not at all. "What can you do?" The employee said, "I'm a carpenter." The farmer smiled and said, "There's work here for you." The farmer was also without heat. He ordered the employee to fill every crack in the house to insulate against the cold. Papa helped as best he could.

Upon completion of the work, the farmer gave the two men four sacks of beans. As the two loaded the beans onto bicycles, the light of the wintry day was disappearing. The farmer said, "Let me see that watch again." Papa's heart pounded. He displayed the watch in the palm of his hand. He pressed for the chime. The farmer listened. He propped his hands against his hips. He said, "I've got enough diamonds and gold to open a jewelry store of my own. I'll give you a sack of beans for the watch."

Papa said, "Make it two." The farmer said, "One sack of beans. That's it." Papa thought about the seven stomachs he yearned to fill. He said, "I'll take the beans."

The Gillebaard family survived and Papa told the story many times. He always ended by saying, "The skills of labor are worth more than precious gold."

And so today, what matters the price of gold and silver? In time of need, what will they buy? A sack of beans? A milkless goat?

When a man is starving, a sack of beans or a milkless goat is what he wants. At that time, it is better to have gold and silver than worthless paper money. Better yet, have the food and fuel you need

to get you through the crisis, so that you do not need to give up your gold and silver. Gold and silver are to be reserved for the far side of the controls-induced shortages.

This incident points to another neglected feature of mass inflation economies: *in a major crisis, wealth flows from the cities to the countryside.* The cities live in terms of the division of labor. This division of labor collapses under the pressure of price controls and rationing. With it collapses the wealth of the urban areas during the period of the controls. The cities have only "heirloom reserves" to call upon, once the financial medium of exchange becomes worthless.[6]

World War II Controls: Germany

Survival-oriented newsletters place a lot of emphasis on the German experience of 1921-23. This was the period of the great German inflation, the worst to hit a modern industrialized nation in this (or any) century. The Hungarian inflation of 1946 was worse, but Hungary was not industrialized and was not so vulnerable to movements of monetary prices. Yet I think this interest in the German inflation of 1921-23 is misplaced. That inflation was not a repressed inflation. Prices were generally free to rise. The money markets were relatively free, and the dollar served as the standard. The Weimar government simply didn't have the political clout to impose full-scale price and wage controls. This is why I am firmly convinced that the crucial period of modern history for us to re-examine is the period 1933-48 in Germany, for these were the years of full controls imposed by strong central governments: first the Nazis and then the Allies.

The Nazis were essentially Keynesians in their economic policies —crude Keynesians, no doubt (not that many equations and charts), but Keynesians nonetheless. Keynes himself admitted as much in the "Foreword" to the 1936 German edition of his influential *General Theory of Employment, Interest, and Money.* Here is a quotation that you are not going to come across in a standard college economics textbook or the *American Economic Review.* It is simply too embarrassing. But Keynes wrote it:

> The theory of aggregate production, which is the point of the following book, nevertheless can be adapted much easier to the conditions of a

6. Gary North, "'Valuables' During Hyper-Inflation," *Successful Investing in an Age of Envy* (Ft. Worth, Texas: Steadman Press, 1983), ch. 20.

totalitarian state [eines totalen Staates] than the theory of production and distribution of a given production put forth under conditions of free competition and a large degree of laissez-faire. This is one of the reasons that justifies the fact that I call my theory a general theory.[7]

Hitler's tightening of controls over the German economy was made easier because of a suggestion in 1931 by Henry Stimson, when he had been the U.S. Secretary of State under Herbert Hoover. At a special meeting in July, 1931, Stimson had met with the British Prime Minister, Ramsay Macdonald, the French delegate Flandin, and Germany's Chancellor, Bruning. The topic of concern: How to stop a feared depreciation of the German mark? Stimson's answer: prevent the outflow of marks. In other words, impose *mandatory exchange controls.* As Jacques Rueff, the French economist who had been present at the historic meeting, related three decades later: "The proposed step was quite unprecedented. There had never been a general immobilization of capital within a country."[8] A committee was set up in Basel, Switzerland to draw up the legal framework for the freeze, the Standstill Committee. This was an historic turning point, as Rueff relates:

> Thus when Hitler assumed power he found already established the system that would enable his regime to function and endure. Contrary to general belief, Dr. Schacht [Hitler's finance minister] did not invent Hitler's monetary policy. It was devised and established, almost unconsciously, by the Standstill Committee, and it was to have tragic consequences.
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> Hitler wanted to rearm Germany as quickly as possible, so he had to be able to spend without limit. Under the previous system he would have been unsuccessful, for inflation would have entailed the depreciation of Germany's currency and the German people would not have tolerated a recurrence of galloping inflation. But the new system, in making it possible to keep the newly created purchasing power within Germany, avoided the normal effects of a budget deficit—in particular a rise in foreign exchange rates. Dr. Schacht applied the principle of capital immobilization with exact thoroughness, and to the extreme limit. The seeds had been sown; all that was required was to wait for them to germinate.
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> In practice, the whole process was comparatively simple. Hitler's

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7. Translated, along with a reproduction of the original German text, by James J. Martin, in his book, *Revisionist Viewpoints* (Colorado Springs, Colorado: Ralph Myles Publisher, Inc., 1971), pp. 203, 205.

8. Jacques Rueff, *The Age of Inflation* (Chicago: Regnery Gateway, 1964), p. 11.

spending, without income, was pushing prices up—a typical inflationary pattern. Rising prices were politically undesirable, however, so existing levels were forcibly maintained under drastic penalties, eventually including death.

Since rising prices did not offset excess demand, rationing on an ever-increasing quantity of commodities was instituted. In 1934, when I was sent to Germany to negotiate a preliminary clearing agreement between France and Germany, Dr. Schacht said to me: "Of course, we've been short of many things. Now I hear that since yesterday, oddly enough, we're also short of zinc bathtubs. However, it doesn't matter; today I am issuing an order rationing zinc bathtubs.". . .

By gradually expanding his policy of rationing, Dr. Schacht built the entirely new system which is now ascribed to him. There had been inflations before, but there were no precedents for the suppressed inflation of the Hitlerite regime.[9]

An incredibly complex system of national economic planning was imposed on the German economy. A summary of its structure—little more than an outline—takes 25 pages of Nicholas Balabkin's book, *Germany Under Direct Controls.* In 1939, there were 7 national groups, one for each major industry, under the National Economic Chamber. There were 46 economics groups under them. There were 232 trade subgroups at the bottom.[10] Over 1,100 price offices were set up in the cities by 1942.[11] This is central economic planning in a nutshell. It's a pretty huge nutshell. And evaders cracked it constantly.

The Germans really did monitor official prices. If 1913-14 is taken as a base year (100), the cost of living index in 1936 was about 125. (Don't pay too much attention to price indexes, except as crude estimating devices for comparison purposes; they can be misleading except as broad outlines.) In 1944, the index stood at 141.[12] That's where the index stood. By 1944, that's about all of Germany that was still standing. Maybe the Nazi bureaucrats couldn't control Allied bombing, but they sure did control prices, meaning reported prices.

Percy Greaves, author of *Understanding the Dollar Crisis,* was a representative of the European division of the Carnation Milk Company in 1936. He once described the kind of games that were played by German retailers. They would buy cardboard imitations of cans of Pet

9. *Ibid.,* pp. 12-14.

10. Nicholas Balabkins, *Germany Under Direct Controls: Economic Aspects of Industrial Disarmament, 1945-1948* (New Brunswick, New Jersey: Rutgers University Press, 1964), p. 48.

11. *Ibid.,* p. 63.

12. *Ibid.*

evaporated milk and stack them up to make it appear that there was plenty of milk available. Naturally, there was rationing. Prices no longer served as anything but propaganda devices, both domestically and internationally. It was all show.

The Full Employment "Miracle"

It is interesting that the "full employment" policies of this early phase of the Nazi regime have captivated Keynesian economic historians. They excoriate the deflationary policies of Hoover and Germany's Bruning. But the recovery phase of 1933-36 in Germany, as in the United States, seems like a success story. In four years, unemployment in Germany went from 5.6 million, or 31% of the working force, to 1.6 million in 1936. As Prof. Hans Sennholz comments, "This remarkable revival of economic activity was achieved by an ingenious combination of dictatorial methods that gradually lowered the real costs of labor and otherwise reduced business costs."[13] It was essentially a Keynesian "miracle": the reduction of real labor costs through monetary inflation. In 1933 and 1934, some 4.6 billion marks were created, an amount almost equal to total tax revenues of the Reich in 1933; it was over 8 billion for 1935-36.[14] Sennholz summarizes the nature of the Hitler "miracle":

> At the end of 1936 German unemployment had fallen below the one million mark, which in those baneful years of worldwide depression meant full employment. The economic expansion together with the wage freeze since 1933 had significantly reduced labor costs, which had brought forth the desired demand for labor. As production expanded while wage rates were frozen the unit cost of production declined substantially, boosting profits significantly. But goods prices began to rise, which prompted the administration in 1936 to impose comprehensive price controls. By 1939, at the beginning of the war, prices had risen merely 9 percent in six years, which in modern terminology would be called a remarkable stability. Of course, the German economy was no longer a market system but a command order organized for war.[15]

The "Hidden Tax" System

Taxes were raised in 1939. Income taxes went to 50%, but not to exceed 65% of income. Excise taxes were levied on liquor and

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13. Hans Sennholz, "The Second German Inflation and Destruction of the Mark (1933-1948)," *The Journal of Christian Reconstruction,* VII (Summer, 1980), p. 54.

14. *Ibid.,* pp. 54n, 55n.

15. *Ibid.,* p. 56.

tobacco. In 1941 and 1942, there were increases in the corporate income tax. In July, 1942, a lump sum payment from home owners, equal to 10 years of real estate taxes, was extracted.[16] Other taxes were imposed. Sennholz's account of what happened next is significant, for we are likely to see similar strategies on the part of our own government:

> Despite all efforts at extracting revenue from every conceivable source, huge deficits remained and grew bigger during the later years of the war. And once again the Reichsbank was called upon to grant short-term assistance through the purchase of Treasury bills. Its printing presses were rolling. But simultaneously the fiscal authorities developed an ingenious method of finance that noiselessly converted a large share of the Reichsbank debt and currency to middle and long-term debt. This method made all government appeals to public patriotism superfluous, and eliminated all public campaigns and drives for the subscription of war bonds and notes. The government simply placed its medium and long-term obligations with the financial institutions that were accumulating the savings, i.e., with commercial banks, savings banks, credit unions, and insurance companies. As the quantity of available consumer goods was shrinking throughout the war, making way for armament production, a rising share of personal income no longer found real goods and therefore was saved. Upon deposit of these savings with financial institutions they were immediately invested in medium and long-term obligations of the Reich.[17]

Sennholz does not mention it, but this was almost precisely Keynes's solution to the war financing problem in England. He devised an ingenious scheme of deferred pay. He wanted to preserve incentives to work, yet also extract real income from workers. Balabkins describes the plan. "The plan proposed to place a portion of current incomes in special accounts to be released only after the war. 'Freezing' a part of wartime incomes, rather than taking it away in direct taxes, would preserve the incentive to earn money incomes and discourage a withdrawal of labor from the labor market while cutting civilian demand and thus release the additional resources for the war effort. Though Keynes's plan was implemented only partially, it dramatized the part taxation can play in an overall scheme of direct controls."[18]

Did the scheme work in Germany, where it was in no sense "partial"?

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16. *Ibid.,* p. 59.
17. *Ibid.,* p. 61.
18. Balabkins, p. 45.

Sennholz describes how quietly the sheep went to the slaughter:

> The public was hardly aware of this "noiseless" war financing. The gradual impoverishment was accompanied by a rapid growth of savings that were generally mistaken for rising personal wealth. After all, everyone could watch his bank account balance growing steadily, promising better living conditions in the future. Many bought new life insurance or greatly increased their coverage. Of course, these funds, too, were channelled directly to the treasuries of the Reich.[19]

Yet even this forced savings program was insufficient. The Reich still had more bonds to sell than it had buyers. So the central bank continued to buy the government's debt by creating more fiat money. The quantity of notes doubled from 1933 to 1939. Then for two years the money supply rose by only 6 billion marks. Then it accelerated. It doubled from 1941 to 1944. It doubled again during the last 12 months of the war.[20]

The Allies Maintain the Controls

The standard of living in Germany by 1944 had collapsed. The war had done its work. Yet the illusion of stable purchasing power was preserved by official prices. There had been controls on some prices since the pre-Nazi days; the total freeze came in 1936; the bombs blew away Germany's houses and industry; but the bureaucrats controlling official prices went merrily onward. Sadly, the Allies extended this Nazi nonsense until June 19, 1948, when the military government sanctioned Erhard's currency reform; the next day, Ludwig Erhard announced the end to price controls.[21] The reform also involved a somewhat complex contraction of the currency, with debts denominated in the old marks being reduced by 90%.[22] General Lucius Clay, the Allied director of economic policy, backed him up, and the nightmare ended. The German economic miracle began. By 1949, the German production index stood at 143% above what it had been in 1948.[23]

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19. Sennholz, p. 61.
20. *Ibid.*, p. 62.
21. This, at least, was Erhard's version. His published accounts appear in his books, *Prosperity Through Competition* (New York: Praeger, 1958) and *Germany's Comeback in the World Market* (New York: Macmillan, 1954).
22. Sennholz, p. 68.
23. Bruce Bartlett, "Ludwig Erhard and the German Economic 'Miracle,'" *ibid.*, p. 75.

But in 1945 there were no signs of a miracle. There were bombed-out houses. In the English-American zones of occupation, about 25% of prewar housing (urban) had been destroyed. Yet millions of displaced Germans poured into these two zones from the Soviet-occupied eastern zone. The Nazis had rationed housing for years, even going so far as to assign people to private homes. Sennholz also reports that relatives of his in various cities would "assign" him a room, so that if housing authorities came by, they could say that the room belonged to cousin Hans. He said he was very popular—just so long as he never actually showed up to visit.

Housing control was put into the hands of local bureaucrats. In overcrowded communities, adults were assigned minimal living space. Officially, this was 4 square meters of floor space (about 36 square feet), excluding kitchen space. Anyone under the age of 14 received half this space.[24] The British and American zones simply preserved all the Nazi housing laws. There was one change: An infant under a year was assigned nothing.[25]

Prior to 1947, there had been no central plan, so at least refugees could truck and barter for space more easily. Building was mostly confined to "gray" and black markets. Rents were frozen in 1945, but of course this was a freeze on money prices, and money didn't talk in Germany by 1945. Barter did. Rents in 1948, just before the currency reform, were what they had been in 1936. Money, as an allocation device, was dead. It was good for paying off debts, paying taxes, and presenting (along with a ration ticket) to sellers. The sellers seldom had much to sell. In 1947, if you had a roof over your head and some coal, you were thankful. In that year, national income was barely half of what it had been in 1936.[26]

Survival Means Barter

The Allies set 1,500 calories as a daily ration for Germans, including coal miners. Usually, they received 1,000. Yet it takes over 2,000 to maintain adequate nutrition, and over 3,000 for heavy labor.[27] Food was at a premium. So Germans did what other captured people have done: they bartered with their captors. Americans sold food and cigarettes, and Germans worked as servants or sold

24. Balabkins, p. 194.
25. *Ibid.*, p. 197.
26. Sennholz, pp. 63-64.
27. Balabkins, pp. 106-8.

family heirlooms. Cigarettes became the coin of the realm. They were fairly divisible, transportable, and they were highly recognizable. They were not very durable, but they were smoked, and this kept them scarce. Probably the highest paid workers in Germany were those who worked as cigarette producers, since they were paid "in kind," that is, with cigarettes. They could buy food.

This brings us to a curious fact. People living in abject poverty want to smoke. There was a market for cigarettes in every prisoner of war camp in the war. There was a market in Germany right up to the currency reform of 1948. A person who is thinking about a highly desirable investment for a period of price controls might consider cigarettes. They can be canned, using dry ice to drive out air from the container. But more simply, you can buy canned cigarette tobacco and cigarette paper (one brand: Brown & Williamson's Bugler). A hundred cans stored in a basement would be a highly marketable good under a control economy. Another good like cigarettes is (and was) coffee. It, too, was a premium good. It, too can be stored inexpensively. Coffee lovers will probably settle for freeze-dried crystals, which are a lot more compact if storage space is a problem for you (and if you follow the guidelines in this book, it soon will be).

Barter became the means of economic survival. Thus it always is under price controls, for prices are denominated in official money. Balabkins estimates that in 1947 and the first half of 1948, fully 50% of all production went into the black markets or into barter.[28] This meant that hoarding—a pejorative term for saving—was necessary for family survival. Saving money was insane; money bought nothing. A man had to save hard goods. Balabkins' summary applies to all inflated currencies under price controls: "The Reichsmark preserved a stable purchasing power for the legal food ration, rent, gas, electricity, taxes, and fares. The Reichsmark remained a unit of account and a medium of exchange, although it bought virtually nothing more than the highly inadequate food ration. But distrust of its future value led, during the last half of the year prior to the currency reform, to flagrant hoarding of goods."[29] Translated from professorial jargon, this means: official prices meant nothing, rationing meant something, and hoarding meant survival. What was flagrant

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28. *Ibid.*, p. 147.
29. *Ibid.*, pp. 147-48.

was not the hoarding; what was flagrant was the policy of repressed inflation.

How significant was the black market? The greater the discrepancy between fixed prices and black market (free market) prices, the more goods and services will tend to flow into the black market. Walter Rundell's study of post-War black markets in occupied nations offers the following estimations of the discrepancy between prices, legal vs. illegal. "In the spring of 1947 black-market quotations in the American zone were approximately one hundred times the legal prices for soap, butter, sugar, saccharine, coffee, flour, hosiery, and flints. (Presumably prices were even higher earlier in the occupation.) Oleomargarine, liquor, and eggs commanded prices seventy-five times higher than the legal ceilings; whereas potatoes, beef, and Leica cameras sold for fifty times more than the legal limit. Coal, gasoline, rubber tires, light bulbs, suits, and dresses sold for prices twenty-five times higher than those prescribed governmentally, while electric wiring and typewriters sold at ten times the legal rate. Average black-market prices ranged between fifty and seventy-five times the legal prices."[30] (These enormous price discrepancies should have warned Rundell against accepting the estimate of Mendershausen in 1949 that only 10% of the economy was transacted on the black market.)

Henry Wallich is a member of the Board of Governors of the Federal Reserve System. He is also the author of a book on the post-War German economy, *Mainsprings of the German Revival* (1955). His description of the German economy after 1945 is accurate and grim:

> A growing proportion of goods found their way into gray or black markets. It became increasingly difficult to do business and even merely to exist within the limits of the law. Firms selling all their output through legal channels could not replace their stocks of raw materials nor hold their labor. Individuals could scarcely survive on daily rations of 1,100 calories that often were not met, and on coupons for one pair of shoes every fifteen years if available. . . .
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> Grotesque conditions resulted. Each day, and particularly on weekends, vast hordes of people trekked out to the country to barter food from the farmers. In dilapidated railway carriages from which everything pilferable

30. Walter Rundell, Jr., *Black Market Money: The Collapse of U.S. Military Currency Control in World War II* (Baton Rouge: Louisiana State University Press, 1964), p. 50.

had long disappeared, on the roofs and on the running boards, hungry people travelled sometimes hundreds of miles at a snail's pace to where they hoped to find something to eat. They took their wares—personal effects, old clothes, sticks of furniture, whatever bombed-out remnants they had—and came back with grain or potatoes for a week or two. Many who lacked the strength to provide for themselves in some such way succumbed to their hardships.

Businessmen had to engage in similar uneconomic pursuits. Firms producing readily usable goods like shoes or light bulbs paid their workers in kind [goods], in addition to their regular wages. Firms in less convenient lines would try to shift part of their output so as to have something barterable. If that was not possible they would trade part of their output against consumer goods or give their workers coal. An even more complicated system of barter had to be carried out to secure raw materials, spare parts, and fuel. Only a part, eventually perhaps no more than half, of total output continued to be sold subject to official controls at legal prices.

These conditions finally led to an almost complete repudiation of the currency. In legal transactions money was of secondary importance compared to the ration coupons that went with it. In gray or black dealings, where fears of currency reform and of the tax collector made large money hoards especially unwanted, barter was the prime form of operation. The general goal of business was to buy as much and sell as little as possible, to build up physical assets in plant, equipment, and inventory, and to preserve substance by not selling against paper money. The cigarette became standard money over large sectors of the economy, both as a means of payment and as a measure of value—a curious commentary on the textbook view that durability is an essential characteristic of the money stuff.[31]

Germans learned that some goods were not under the controls. Immediately and continually, capital (labor, goods, space) began to be devoted to the production of these goods. First, as in the U.S.A. in 1942-46, there were "new" goods. Usually, these were old, familiar goods with new names or slightly modified appearances. The new goods could be set at a much higher price, since there was no existing price guideline. Ash trays, fancy lamps, toys, and other "luxury" goods became staples, for at some monetary price or in exchange for some good or service, a man could buy these uncontrolled products. This meant that these items preserved some degree of purchasing power.

This "new products" game is a familiar one in all price-controlled

31. Henry Wallich, *The Mainsprings of the German Revival* (New Haven, Conn.: Yale University Press, 1955), pp. 64-66.

economies. Germany's post-War economy has been dubbed "the ash tray economy" by Sennholz, who went through it. Ashtrays and other essentially useless items, along with luxury goods, were not under the controls. Thus, they could command true market prices. This is what businessmen preferred to produce, rather than necessities, which were under the controls and therefore unprofitable.[32] In short, controls produce the opposite effects of what was promised: put on in order to help the average citizen "make ends meet," they lead to a luxury-goods market. But as Balabkins shows, the Allies imposed controls to strip the German economy.[33] The controls did the job. In this sense, the controls "worked."

The Soviets Get Our Currency Plates

What is not discussed very often is that the U.S., meaning New Deal officials (especially Harry Dexter White) capitulated to the demand of the Soviet Union that the Soviets be given a duplicate set of the plates that were to be used to print the Allied occupation currency.[34] As historian Vladimir Petrov remarks, "It was also a unique act in the history of currency manufacturing: never before had any government voluntarily relinquished its sovereign control over the issue of currency."[35] This decision had been actively resisted by the Director of the Bureau of Engraving and Printing, but to no avail.[36]

The plates were delivered to the Soviets in April, 1944.[37] A year later, General Eisenhower reported to the War Department that the Russians distributed the A.M. (allied military) marks to their troops "without accountability, without regard to scales of troop pay, and in any quantities the troops request. Such A.M. marks are distributed by the handful with rations. . . . Our troops are receiving large quantities of Russian A.M. marks from Russian troops, civilians and displaced persons for cigarettes, candy and even gratis."[38] This money was then converted by American troops into U.S. dollars,

32. Balabkins, pp. 161-62.

33. *Ibid.*, ch. 1.

34. Harry Dexter White was the Undersecretary of State for international monetary affairs. According to Whittaker Chambers, he was also a dedicated Communist agent: *Witness* (New York: Random House, 1952), pp. 67-68.

35. Vladimir Petrov, *Money and Conquest: Allied Occupation Currencies in World War II* (Baltimore: Johns Hopkins University Press, 1967), p. 107.

36. *Ibid.*, p. 115.

37. *Ibid.*, p. 189.

38. *Ibid.*, pp. 189-90.

and the U.S. Treasury had to foot the bill. The government's own highly conservative estimate of the bill was over $530 million for all Allied Marks currency exchanges into U.S. dollars, including the Russian-produced marks.[39] The Soviets used their new currency to buy up West German and imported American goods at the official prices. "The flow of currency westward was prompted by a substantial difference in the purchasing power of the mark between the Soviet zone, where the only commodity supplied by the occupying power was the currency itself, and the American zone, where the occupation forces were lavishly provided with everything from the home country. Even when the mass movement of people fleeing to the west had slowed down, the currency traffic was continued by thousands of German smugglers. It lasted at least until the summer of 1947. . . ."[40] The result should have been predictable in a price controls economy: shortages and black markets.

The Flow of Wealth

Monetary inflation, coupled with price controls, will give you shortages every time. But capital seeks its highest return, and the luxury goods are the ones that are, in effect, subsidized by the policies of repressed inflation.

The phenomenon witnessed in Germany and Austria during the inflation of 1919-23, and in Holland in 1941-45, took place in Germany: the transfer of wealth from the cities to the countryside. A story told by Sennholz is illuminating (taken from my book, *Successful Investing in an Age of Envy*). He had known a German gentleman in the late 1940s who had understood the economic implications of the coming to power of the Nazis in 1933. He had been an instructor of philosophy in a gymnasium in these years. (A gymnasium in Germany was not an exercise room; it was a very rigorous academic high school.) He took two steps when Hitler became Chancellor in March of 1933. First, he switched from teaching philosophy to teaching mathematics. Math is far less controversial in a tyrannical regime. Second, he began looking for a job in some rural school. He located one a few years later. He moved to a quiet rural town in southern Germany prior to the War. He bought a home, some land, a few farm animals, and tools. He emerged from the War unscathed, with his capital intact. He had taken a moderate drop in income and status prior to the War; this decision allowed him to survive. He had lived in

39. Rundell, *Black Market Money,* p. 7.
40. Petrov, p. 190.

the industrial city of Essen; in 1945, it was a pile of rubble.

Balabkins argues that the policies of controlling prices were maintained by the Allies as the basic tool of stripping Germany of its remaining industrial wealth. The Americans and the Soviets wanted to reduce Germany to a third-class agricultural power. The British were skeptical. But the price controls made any British doubts superfluous. Balabkins writes: "In a war the aim of direct controls is to bring about speedy, efficient, and maximum utilization of available resources for the war effort. But in postwar Germany the Allies aimed not at the maximum utilization of industrial capacity but at precisely the opposite. Industrial disarmament of Germany required that only minimum industrial production be permitted. Thus, the reinstated direct controls were considered proper means to attain the envisaged retrogression of the German economic status for security purposes."[41] Petrov says virtually the same thing: "There is no question at all that when the victor's intent is to harm the occupied country, the manipulation of monetary circulation will serve his purpose, especially through induced inflation."[42] As a program of industrial paralysis, price controls are uniquely efficient.

Why then, do nations "do it to themselves"? Why do the politicians impose policies on their own people that are best suited for victorious armies as programs for the destruction of the defeated enemy? Why do voters not understand that the call for controls is suicidal?

Conclusion

If the justifications of controls are wartime stability and social peace, rather than production, then the experience of the U.S.A. indicates that price controls can work, assuming: 1) citizens are ignorant of economics; 2) citizens are envious and will support the war effort only if they can exercise their envy; and 3) the controls are not seriously enforced. The experience of Germany under the Nazis and the Allies indicates that if the controls are enforced, they will destroy output and therefore destroy income. They lead to distortions that are mitigated only by such devices as black marketeering, barter, hoarding, production of luxury (uncontrolled) goods, and rationing.

Controls cannot last. No matter what men tell pollsters, they will not live under price controls forever. Three years, five years, even

41. Balabkins, pp. 208-9.
42. Petrov, p. 262.

two decades: but sooner or later men either abandon the controls (Truman, 1946) or they abandon the currency (Germany, 1946). In 1948, Germany threw out controls, reformed (shrank) the currency, and started over. They went back to marks after having used cigarettes.

If controls are reimposed and enforced, we will see the revival of the money of the prisoner of war camps. That's because we will be living under the economy of the camps: controlled, bureaucratized, malevolent, armed, and inhumane.

Plan ahead.

16

THE LOGIC OF BARTER UNDER CONTROLS

During October, 1945, Newsweek *magazine began an on-the-scene survey of cigarette barter in the principal European cities. Reporting from their assigned bases, the magazine's correspondents recorded that in Vienna one United States cigarette was the standard tip for a waiter and that twelve packages would buy a new Leica camera. Other* Newsweek *correspondents chronicled that in Rome two United States cigarettes constituted a satisfactory tip, . . . In shambled Berlin, thousands of "barter boards" had been raised, and on them thousands of Berliners were listing articles they had for barter. Usually the offers were tested in United States cigarettes, coffee, chocolate, or sugar instead of currency. Typical offers were one diesel engine manual for a package of cigarettes. A substantial part of Berlin sidewalk barter was in single cigarettes. . . . The single package was an excellent spending unit since it was readily divisible into twenty individual cigarettes. Furthermore, neither ingenious law evaders nor local politicians could duplicate counterfeit a package of Camels or Luckies. Also, an unbroken package could be held in reserve for many weeks without ruinous loss of value and, even more importantly, a cigarette once smoked is out of circulation for good.*

Charles Morrow Wilson
Let's Try Barter (1960)

Wilson's book is subtitled, "The Answer to Inflation (and the Tax Collector)." It is significant that the book, long out of print, was reprinted in the late 1970s in paperback and again in the early

1980s.[1] The publishers have seen the renewed interest in barter that is rapidly spreading across the country. They are trying to cash in on barter.

There is a paradox here. Why should anyone want to "cash in" on barter? If barter is the wave of the future, why should people be willing to take paper money in exchange for information on barter? The answer is simple enough: barter is always supplemental to paper money transactions, except under conditions of economic collapse. Barter is an alternative to the conventional markets. Money still talks on these conventional markets, but barter certainly whispers. And when people are trying to escape the clutches of the tax collector, a whisper is just about right. Today, taxes are primarily direct in nature: income taxes, Social Security taxes, corporate income taxes, sales taxes. Once price controls are slapped on, and price inflation becomes repressed inflation, the tax becomes insidiously indirect. The government confiscates people's capital by means of fiat money and priority purchasing slips—always possessed by high government officials, their beneficiaries, and the people who are willing to take the risks associated with black market activity. If people are entering the barter markets today, it is not because they are concerned about survival. They are looking for something new, something off the beaten path. They are trying to profit from their own sharp trading in markets that are narrow and less determinate, since participants have less knowledge about other bargainers. To have a broad market, you need a money economy. *That's the problem with price controls: they drastically narrow the markets, thereby reducing information.* Sharp bargainers obviously benefit from this narrowing of the market. Those who have been trading on these narrow markets, sharpening their skills, getting the "feel" of face-to-face bargaining, have an inside track on those who are entering the markets late, possibly out of desperation. Price controls cannot benefit those who have little familiarity with the unconventional alternative ("black") markets. But for the few who are quite familiar with these markets, price controls can be a bonanza. If you think I'm wrong, try buying a new Leica camera today for a dozen packages of cigarettes. (One reason why Leicas were so cheap was that we made it illegal for Germans to own a camera.)

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1. Charles Morrow Wilson, *Let's Try Barter,* published by Flag Press, 143 S. Beach Ave., Old Greenwich, CT 06870 ($5.95). There is a new introduction by Karl Hess.

The Tax Collector

Karl Hess, the ex-liberal, ex-conservative, ex-libertarian, ex-urban homesteader who once was Barry Goldwater's speech writer, now lives in rural West Virginia. He is absolutely penniless. He gets by nonetheless. The IRS has a lien against his property for nonpayment of income taxes. In response, Hess has earned his living by bartering for a decade. He earns no money by design. He trades his sculptures for whatever he can get. He gets by. The IRS gets nothing.[2]

Admittedly, the IRS has claims on all income, however received. It has a legal right to get its cut from Hess' profits from bartering. But do you know how much it would cost the IRS to collect anything from him? A lot more than it could collect. How can you evaluate the value of the things he buys? How do you collect from him? Take food off his table? That would force him on welfare. Income derived in cash is more difficult to trace than income from a check. Income from barter is even more difficult to trace. There is little to be gained from following Hess all day long in order to get $5 in taxes out of him. What will the IRS do, go into the hog butchering business? Will it become the marketing agent for Hess' sculpture?

The IRS can afford to ignore a man like Hess. There aren't many of them, and it's the middle-class family that supports the bulk of the government's programs. The middle class is almost completely dependent on checks, bank accounts, salaries that are subject to withholding taxes, and so forth. So long as the middle class doesn't turn to barter—and it couldn't and survive in middle-class comfort—the IRS can afford to ignore tax evasion through barter. Besides, the IRS system rests on voluntary compliance. There is no way that the IRS can collect taxes on transactions that the majority of citizens do not think should be subject to the tax and therefore reported to tax authorities. For example, a middle-class wife may belong to a babysitting co-op: you sit with my kids and I'll sit with yours. Legally, both families must report the total value of the services received on their income tax reports. Do you think they will? Do they know that they should? If they did know, do you think they would comply with the law? Neither does the IRS. As long as only a small percentage of people's transactions is based on barter, there is no reason to

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2. As of 1982, Hess edits *Survival Tomorrow,* P. O. Box 9668, Arlington, VA 22209; 12 issues, $60. I have no idea how he is paid.

worry about them in the offices of the IRS. The problem for the tax collectors comes when the inflation-tax avoiders start buying goods, thereby forcing up prices. This produces the government's response, price controls. Price controls lead to the tax-avoiding response of increased barter and black market activity. Then the tax agencies face a crisis. What a shame.

Yet it was not so long ago that millions of dollars a day were being transacted on the barter markets. Specifically, it was in 1973-74. Monetary inflation had led to price inflation. Nixon slapped on controls by pure fiat order on August 15, 1971, and the printing presses kept rolling. Shortages developed in late 1972 and throughout 1973. Then the Arabs put on their oil embargo, and the supply of oil, already in short supply, started to dry up at the legal prices. But there were other prices.

In late 1973, the newly created magazine, *Saturday Review/World,* was in a real jam. It couldn't locate paper. There was a major paper shortage during this period, and all magazines were scrambling for supplies. The editor was offered the following deal: locate propane gas (used in the ink-drying process), and a paper company would supply 50% of the needed paper. The editor got the propane, and he got his paper not long thereafter. (He prudently declined to tell the reporter where he had located the propane.) By early 1974, according to a survey of 300 corporations made by the trade publication, *Purchasing World,* almost half of them were conducting part of their business by bartering for needed supplies. R. E. France, purchasing vice president for Sun Chemical Co. of New York, frankly admitted that if it were not for barter, "we wouldn't be surviving." The reliance on barter was especially marked in the field of petrochemicals, given its heavy reliance upon oil. Benzene, which had sold for 18 cents a gallon in mid-1972, had skyrocketed to $2.50 a gallon on the world markets by early 1974. Price controls on benzene made it difficult to buy in the legal markets, so firms bartered.[3]

In discussing this period with men in the petrochemical industry, I learned what I had already guessed: the primary source of bartered goods was a network of existing personal contacts within the industry. This is not to say that there were no newcomers acting as middlemen. There were, and stories of self-made millionaires who

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3. *Wall Street Journal* (Feb. 13, 1974).

made their money simply by picking up a phone and persistently calling around are stories that are probably based on fact. But the fact remains that an industry will usually generate its own sources internally. Making a bundle of money takes work, foresight, accurate planning, and probably a whole host of intangibles that are simply not available to most people. But the fact that not many can make a fortune does not mean that no one can. In fact, it means just the opposite. There are services to be performed, and if wealthy industries are willing to pay the freight, someone can make a pile of money. And should the day come that money is little more than a hunting license, then he who can supply the service or goods can demand payment in other goods or services.

Strategy for the Big Payoff

Bernard Cornfeld sold a lot of his ill-fated mutual fund shares with his slogan, "Do You Sincerely Want to Be Rich?" I don't want to imitate Mr. Cornfeld, but you have to ask yourself that question. More important, you must ask this one: What am I willing to give up in order to gain the outside possibility of making a bundle (money or goods)? The strategy I will lay out is the one that can open the possibilities of wealth, but it takes sacrifice. It does not need to take a lot of money, however.

The age of mass inflation will be the age of the speculator. He who forecasts the immediate economic future, acts courageously to meet that future, and then shifts his psychology to pursue another fast-moving market, will be the millionaire of the future. But once controls are reimposed (and I think this will be before truly mass price inflation arrives), the markets will fragment. At that point, the specialist inside any market will have a distinct advantage, since it will not be easy to enter new markets. You won't phone your broker and ask him to buy a thousand of this or a hundred of that. The strategy I recommend is aimed at this secondary period, the period which follows wild speculation on the legal, open markets. The markets I'm talking about may or may not be legal, but they will be crucial for the economy. No matter what the law books say, officials will have to look the other way if they don't want to destroy all production. Legal or not, alternative markets will exist.

There are laws—economic laws—that govern these markets. They must be respected. They are the first step in making large profits in a control economy. I will spell out the most crucial ones

again, though I mention them elsewhere.

1. *Face-to-face contacts.* Men operating on black or gray markets bear a heavy risk, namely, the risk of detection by the authorities. One way to lower this risk is to deal with those who are familiar, people who can be trusted to remain silent. This means old cronies, those who want continuing supplies, those who are related to you, those who share some other common bond. In a control economy, it is as much who you know as what you know. In fact, the what that you know may be the who. Contrary to popular opinion, in a free market economy, what you know is far more important because markets to information are far more open. Competitive bidding—monetary bidding—can offset not having "connections." But a price control economy makes competitive market bidding illegal. This subsidizes the semi-feudal type of economic system: personal loyalty and personal contacts count for more than bargaining ability on an open, competitive market. If you liked the Middle Ages, you'll love price controls.

2. *Low profit margin goods disappear first.* The secret of success in a controlled market is predicting what goods and services are going to be removed from the legal market next. These are the ones that should receive your almost full and undivided attention as a consumer, and at least considerable attention as a middleman. When controls are imposed, those goods that are mass produced, and therefore price competitive, are the most vulnerable to panic runs and production bottlenecks. The necessities disappear, and the limited production, high profit (per sale) items remain on the legal markets longer. The real luxuries may remain available until the very end. Therefore, your secret of success is a new way of looking at the economic world: those items that are most available in a free market economy—most familiar, most taken for granted—are the ones that must never be taken for granted. It will take months of painful learning on the part of the average American consumer to grasp this fact. The faster you learn this simple, yet inevitably ignored law of price controls, the safer your family will be once controls are imposed.

3. *Closed markets subsidize those who have already entered them.* The genius of the free market is its ability to transfer massive quantities of accurate information to those who need it and are willing to pay for it. But the world of price controls tends to favor monopolists. Those who learned the ropes beforehand can more easily keep out newcomers. Rationing and even government-assigned labor pools make it more difficult for people to learn the old trade secrets, let alone the new secrets. Conclusion: you should take steps immediately to begin to master the supply and demand facts of the present industry you intend to specialize in, but with an eye to the future. You must learn about today's world, but you must assimilate this information in terms of a vision of the future which few men share: the end of a

world in which money not only talks but shouts. It is far cheaper now to enter a particular knowledge market, for people are not yet suspicious (and that day is coming as surely as controls are coming), the greatest of all barriers to entry (private barriers, anyway) is erected: fear, coupled with jealousy. Today, the information is relatively cheap, monetarily speaking. Within 18 months after price controls, or 24 at the outside, this kind of information will become far more expensive and unobtainable for most people.

Before considering a strategy for successful brokerage operations (middleman), let's consider something more mundane. By looking more carefully at a consumer item that will be in short supply, we can draw more accurate conclusions about the world of manufacturing. Our consumer item: toilet paper. In 1973, Japanese housewives became convinced that supplies of this product were about to disappear, and as is so often the case under price inflation, the prophecy became self-fulfilling. They rushed to the supermarkets and bought every roll in sight. This increased the panic. These kinds of panic runs are magnified under price controls, simply because supplies really are limited and prices are not allowed to rise (thereby stimulating producers to even greater output). Here is a mass produced product that is highly price competitive. It has a low profit margin per sale. Off the shelves it goes, and it is not replaced. When it is replaced, it will be rationed. (That, I assure you, will alter a lot of life styles—life styles that people today give little thought to.)

What kind of strategy is appropriate? I guarantee you that not one man in a thousand has even thought of the best strategy, and fewer still have acted. Install a bidet ("biday"). They are seldom advertised in America, but they are well known in Europe. The Kohler Co. sells them, and they are considered to be very exclusive. They are devices that direct a stream of water to the appropriate location, and they are more sanitary than TP. (And they are a lot more comfortable than corn cobs.) I can see a rapidly growing market for these devices within a year after controls are imposed. It will be a good item to begin manufacturing, too, because it is a new product and therefore more easily priced (higher priced). This is one bathroom appliance that will be easily salable when the panic hits.

The person who hears that controls have been imposed but who doesn't buy a bidet (beDay) or literally dozens of rolls of TP, is being foolish. Rolls should be stored in a mouse-proof, dry area, possibly

inside those styrofoam or plastic picnic baskets with the lids taped shut.

For those of us who have installed a Frantz Oil Filter or a Motor Guard oil filter on our automobiles or trucks, that use toilet paper as the oil filtration insert, the bidet is only a partial solution. The Frantz allows me to reduce drastically the number of my car's motor oil changes, as long as I insert a new roll every 2,500 miles, adding one quart of oil (because the toilet paper absorbs about a quart). As any car engine operates, it uses some oil—a quart every 1,500 miles is normal. This lost oil must also be replaced. What the Frantz and Motor Guard filters do is to eliminate the messy job of draining oil. I have used both brands; Motor Guard is somewhat easier for the average man to change the TP filter. Both are high quality pieces of equipment; both sell in the $60 to $75 range. I change my oil about every 50,000 miles, with no ill-effects in my cars. This requires planning: I'll have to buy two cases of oil for each car, plus a case (96) of 500 sheet, two-ply rolls. (About the only decent toilet paper today is the kind you order in cases from commercial distributors. The "squeezable" super-soft tissue is actually filled with lots of air: 400 sheets made to look like the old 500-sheet rolls of the early 1970s. Order TP in a case from your local church, hotel, or other commercial establishment. Piggyback your order.)

There are two other similar by-pass motor oil filters that are worth considering: the Harvard and the Arnco. The Harvard uses a Cellu-Life filter element that must be changed about every 15,000 miles. The filter element costs under $20. The filter costs under $70. The Arnco is actually a mini-oil refiner. It has a vaporization chamber which is powered by your car's battery as you drive. It literally vaporizes anything that isn't motor oil. Thus, you can use it for diesel engines without fear of any fuel leaks into the oil, meaning without fear of a drop in your oil's viscosity. No acids can build up because acids need water to form them, and the vaporization chamber eliminates all water. Its cotton fiber element needs changing every 10,000 to 20,000 miles; less often for freeway or distance driving. It is the most sophisticated by-pass oil filter I have seen; it costs about $120.

You literally need never change your motor oil with any of these filters. More important, they all filter particles larger than one micron. This means that the build up of metal shavings, grit, and

other particulate matter never takes place. The oil stays permanently clean. Your oil normally gets dirtier and dirtier above 1,000 miles of driving. Not with one of these filters. So your engine is protected. For more information on these ingenious filters, write them at:

Frantz Oil Filters
P. O. Box 6188
Stockton, CA 95206

Motor Guard Co.
P. O. Box 1834
San Leandro, CA 94577

Harvard Filter Co.
P. O. Box 108
Evansville, WI 53536

Arnco Filters
P. O. Box 2707
Harbor, OR 97415

As you might imagine, gas station attendants and car repair mechanics are apoplectic about these units. They can double the life of an engine and eliminate all major overhauls. I have used two brands of these filters for many years, with no ill effects. No muss or fuss in changing oil. No getting under the car. No replacement oil filters ($7.00 up) except once every four or five years. Clean oil all of the time. My 1972 Toyota still runs fine; it has had three oil drains since 1975. Total miles on the car: 125,000.

Yes, there are defects. You have to keep checking the oil once a week, to make sure that the oil lines haven't developed a leak. But you should check your oil level weekly anyway. Some people put off having regular maintenance on their cars because they no longer have their service station mechanic change the oil. They forget that clean oil doesn't solve other lubrication problems. But these units will save money on oil, and they will keep your wife from screaming about your use of her turkey roasting pot for collecting used oil. No more burying used oil either.

You will be told that these units are a fraud. You will be told that they lead to ruined engines. You will not be given a single piece of evidence, because no independent testing agencies have ever published negative data on any of these units. I have written to the American Petroleum Institute and the American Society of Automotive Engineers requesting hard evidence on these filters. No tests have been run, they claim, despite the fact that the Frantz and the Arnco have both been on the market for over 30 years. Don't act in terms of rumor; act in terms of evidence.

The companies do not make much money on their products. Why

not? Because the truth is too shocking—no more oil drains—and there are no groups within the auto industry with an incentive to sell these units—not the oil companies, not the repairmen, not the auto manufacturers (who depend on people buying new cars every three or four years). These filter firms all use independent salesmen-installers to sell them. Word of mouth is the way people find out. So if you get the literature and buy a unit, please don't send it back or call frantically to the manufacturer when your local mechanic tells you that the filter will destroy your engine. After 95,000 miles and three oil drains over the last seven years, my Toyota Corolla runs just fine, and when I have the oil tested by independent oil testing agencies, the used oil always is rated clean and safe.

If motor oil gets scarce, you will need two or three cases in reserve. You will also need one of these motor oil filters to reduce your car's normal consumption of oil. Store filter elements, too. You will need every extra mile your car can give you.

It is this kind of thinking that should be dominant in the life of the man who intends to make his fortune in a world of controls-induced shortages. Think ahead, preferably along lines unsuspected by your competitors or potential competitors. It is probably wisest to start where you are.

Become a Broker

What is your own industry or service? What does it need? What did it need back in 1974? What did it need during the Korean War and World War II? Who can tell you? Search him out and chat. Let him reminisce. Take notes. You already have information at your disposal. If you can start with an existing body of knowledge, you can save time and trouble. But even if your own field is not where you think you can contribute much, there are still great possibilities. Realize beforehand, however, that cracking open a new nut is a lot more difficult than sticking with an already cracked one. In any case, here is a strategy for a beginner.

1. *Subscribe to several trade publications in the field, especially those aimed at purchasing agents.* If you don't know which ones these are, ask a purchasing agent. You have selected a particular manufacturing or service industry as your specialty, so you might as well get used to asking questions. Find out which publications are the guide books for the present experts and start learning what they know. Find out who advertises, what products cost,

which are produced by several different firms (price competitive). This is a crucial step: know the publications.

2. *Find out which items are absolutely crucial to the survival of the industry.* For best results, in terms of your profit, look for durable goods that appear in the used goods markets. It's easier to track down used equipment, if you're a beginner, than it is to track down a hundred thousand barrels of oil or several thousand tons of coal.

3. *Start locating suppliers, especially small, independent suppliers, of these key goods.* These will be the people most likely to deal with a newcomer once things get tight, if the newcomer is at least a familiar face. Look for those who supply used equipment, or those who might have a used unit in a warehouse, rusting. Find out now. Keep a record in a central file of which equipment is available from what small supplier. If these people have their own trade newsletter, subscribe. Some of them have computerized information services. One example is the junk yards that specialize in auto parts. Get very friendly with these guys.

4. *You have to create spare time to visit suppliers, purchasing agents, and others who can help you gain information in the field.* They can tell you about books that are helpful. Start collecting a library of these books. If possible, read them at the public library and then order the ones that seem most useful. Your time must be spent now on gathering information of how things work now. Remember, it's your job to figure out how things work in the future.

5. *If you're dealing with equipment, buy the repair manuals or get a photocopy.* This kind of literature must be in your library in advance. Even if you can't understand them, some repairman you hire will. But his abilities to repair goods that are crucial to production will be limited if he does not have access to official repair manuals. Those who have them in advance will be able to exploit (that is, use profitably) this inside knowledge when printing becomes difficult and manuals are scarce. A manual for a discontinued but widely used product will be extremely useful. Be sure to take care of them. If you know where an item is, and you think it will be needed in the future, try to get the owner to locate the manual for you and xerox it.

6. *Rule: in a shortage economy, there is no such thing as junk.* There are only unexploited profit opportunities.

7. Once you have devoted enough time to master some of the literature in your selected field, *start jotting down questions.* If you can locate a library with older issues, check back and see if the 1941-46 issues are still around, as well as the 1950-53 issues. Read about the shortages and how they were solved. Remember: no one else is looking at these magazines. It's all forgotten. It's all history. Old trade journals are a gold mine of useful information for the future. Large firms may even have them available. Find out who the

librarian is and go have a friendly chat. You appreciate librarians. No one else does. Once you have questions, start going to those who may have the answers.

8. *Sources of information: retired old geezers.* These guys are really ignored data banks, if you find them before the data banks are shortcircuited by time and neglect. There is probably an association of retired men in your selected field. Visit a meeting. Ask about the good old days. Let them spin yarns about beating the bureaucrats in 1943. Assuming you ever get into the middleman business, maybe some of them can get you introductions that you need, or tell you where supplies might be located. If you're an old retired geezer, what are you doing sitting around watching daytime T.V. and talking about the good old days with a bunch of old geezers? Go out and make yourself a rich old geezer. Then you won't be an old geezer any more. You will be a distinguished, though eccentric, statesman of the industry. Never forget who it was who fired you when you turned 65. You too may be able to quote Bobby Fisher, who was asked at age 14 what he enjoyed most about chess: "I love to seem 'em squirm."

9. *Trade associations hold annual meetings, and these are important sources of information and contacts.* Once you know enough to start asking the right questions, you should attend one of these meetings, even if it's only a regional one. In fact, especially if it's a regional one. Have a card to hand out: "Joe Entrepreneur, Budget Broker." Get the other guy's card. You can always call him, using his name, when you want an introduction to a purchasing agent or other executive. Names are important. They push open closed doors.

10. *Every man likes to talk about his business to somebody. Be a good listener.* Very few people are, and especially newcomers. There will come a time when people may hesitate to tell the truth about how business operates, but now they are eager to share stories. Don't be embarrassed to ask about details, as long as you've gained his trust. You can write down your notes during the interview (if he doesn't mind) or immediately after. If he's a purchasing agent, he ought to be happy to help you get a start in helping him to get supplies. The more suppliers he has competing against each other, the easier his job is.

11. *The local university or trade school can provide you with gobs of background information.* Unemployed students in chemistry—advanced ones especially—can be used to scout around for supplies of materials once controls make their presence felt. Professors may have suggestions and even personal contacts within the industry. They may be able to help. Nobody pays any attention to them, so why not drop one a note if you want information on marketing? If the school isn't in your area, find out which one is the best in

the field, and order a catalogue from the school (free of charge). Then look up the name of the man in purchasing, marketing, or whatever, and drop him a letter with your question. Limit your letters to any one professor, however, to two or three a year. Don't be a pest or a red-hot. Nobody in academia likes pests and red-hots. These people can give you pile of bibliography on your topic. Your taxes support them, so put them to work for you.

12. *If you're a salesman, get acquainted with purchasing agents in your firm and with the repairmen.* The repairmen will make or break the company eventually. Pump them for information. Salesmen are only glorified order-takers under conditions of shortages, and rational firms lower their commissions on each sale. It takes no talent to sell under such conditions. You must develop new talents. If you stick with sales, try to find someone who will pay you and your company off, at least in part, with goods and services, not simply money. This kind of salesman is valuable.

13. *Slowly, tentatively, and in great humility, start trying out your skills.* This may well take a year. So what? We've all got to start somewhere. Once controls go on, time runs out much faster. Then you will have to hustle. But until then, there is time to learn. Offer to search out some missing product at a price that is lower than the purchasing agent thinks he can get. There is always something that someone needs in some department or other. You may have to get chummy with a department foreman. But if you can start making a few sales-purchases, you'll gain confidence in yourself, and you will have done both the buyer and the seller a big favor. Don't expect to get rich on these early sales. You don't need to get rich if you can get experience. *What you need is self-confidence.* This, more than any other factor, is the key barrier to entry. Everyone says to himself, "I couldn't do that; I don't know where to begin." Indeed, he doesn't; and now you do.

Getting rich isn't easy. As I said at the beginning, it doesn't take money. It takes will, determination, and a lot of careful, patient labor. It takes a vision of the future that is either frightening enough (if you're a consumer) or beckoning enough (if you're an entreprenuer) to move you into positive action. *These problems will be overcome.* They always have been; they always will be. The question to ask yourself is this: Can I be the one who overcomes these problems? If you are, then profits lie ahead.

The key resource, obviously, is time. Time, the irreplaceable resource, constrains us all. But if you don't have a lot of money, time is the only resource that can get the job done. Where do you get it?

You make it. It doesn't come to you. You must work six days a week, not five. You must give up Saturday T.V. I know of no better way to begin. When I decided to go into business for myself, I got rid of my T.V. I couldn't work three jobs, with a fourth and a fifth looming ahead in the near future, if I was a T.V. addict.[4] There isn't enough time. Either you pull the plug on it, or walk away from it, or else it will eat into your capital like a cancer. If you can't do this, then ration your time in front of it. Take a vow that you'll pay 25 cents an hour, or 50 cents an hour, or whatever it takes to get you to allocate your viewing time more rationally (and, incidentally, get your children to do the same), and then use the money for charity, or for buying subscriptions to trade publications, or going to trade association meetings, or buying stamps. But rethink your "free" time.

There ain't no such thing as free time. It always costs you. If you do one thing with your time, you can't do another. Ration it wisely. Lost time now could mean the difference between a fortune and scrambling. Your competitors and potential competitors are also hooked on T.V. Kick the T.V. habit. You're probably a T.V. junkie. It's taking money out of your pocket. Pull the plug.

While you're at it, kick a few other habits. Specifically, reduce your demand for those items that are the big ones under controls: cigarettes, liquor, sweets, coffee. If you can reduce your use value of these items to zero, then the exchange value of them can help you to get necessities and luxuries later on. You can use these items to trade your way into a business designed for a controls-stymied economy. You can use them to buy time, favors, and even survival in a time of real shortages. Better to sweeten up a supplier than sweeten up your coffee (which you just gave up anyway). Buy these goods as a form of capital investment. That's exactly what they are.

Conclusion

"Time is of the essence." This phrase has a specific meaning on a legal document. It also has meaning for today. *Information is not a zero-price resource.* We have to become aware of the sources of infor-

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4. Once I had the businesses operating, four years later, I bought a videocassette recorder. I still didn't have a T.V. set. I was probably the only person in the U.S. in late 1979 who owned a top-of-the-line videocassette recorder and no T.V. I finally went out and bought a T.V. after that. My kids watched too much of it. Frankly, so did I. So I pulled the plug again. I watch old movies that friends or relatives record for me.

mation while they are still relatively easy to locate. *Skills take time to develop.* You don't need to become a professional barter specialist, but a few tricks of the trade won't hurt. Go to swap meets and "flea markets." Do a little trading. Then find out how the old-timers did it or even still do it.

You need time. Time is not a free good. Whatever it takes, buy yourself some time. *Build up a "capital base" between your ears.* Give up leisure to get a head start on the competition. The stakes are too high; you dare not be overtaken in this race for survival.

17

THE STRATEGY OF EVASION

It is not accurate to apply terms like "gambling" or "betting" to situations either of risk or of uncertainty. These terms have unfavorable emotional implications, and for this reason: they refer to situations where new risks or uncertainties are created for the enjoyment of the uncertainties themselves. Gambling on the throw of the dice and betting on horse races are examples of the deliberate creation by the bettor or gambler of new uncertainties which otherwise would not have existed. The entrepreneur, on the other hand, is not creating uncertainties for the fun of it. On the contrary, he tries to reduce them as much as possible. The uncertainties he confronts are already inherent in the market situation, indeed in the nature of human action; someone must deal with them, and he is the most skilled and willing candidate.

Murray Rothbard [1]

The coming era is going to be the era of the speculator. What is a speculator? He is simply a forecaster. He is the entrepreneur who tries to assess future consumer demand. He then goes into the markets to buy up scarce economic resources that are presently underpriced, given the increase of future demand that the entrepreneur expects. Of course, he can be wrong. If so, he will suffer losses. The person who does not serve the buying public better than his competitors will be removed from the economic scene. The consumers, through their purchases of one firm's services or goods, and by their refusal to buy another firm's services or goods, determine who survives. *The consumer is sovereign in the free market.*

This book is a book about entrepreneurship. It deals with the future. It tries to show you what kind of economy is coming. If you

1. Murray N. Rothbard, *Man, Economy, and State* (New York: New York University Press, [1962] 1975), pp. 500-1.

are to evade the devastation that threatens the whole economy, then you must take action today, tomorrow, and next week. Your plans and decisions will be different from those of your unsuspecting friends and associates. You will have a different assessment of the future. We are all speculators, meaning forecasters. Not all of us are gamblers. (I'm not. I have a moral revulsion against gambling. But I am a speculator. I try to forecast the future accurately. So should you.)

W. Allen Wallis was the president of the University of Rochester. He is a long-time defender of the free market. His book, *The Overgoverned Society* (Free Press, 1976), is a grim forecast of what we can expect in the near future: the imposition of price controls. He is even more pessimistic than I am. He thinks that they will not be removed until the end of the century, and they may last longer than that. As he puts it: "The head of a country in which 70 to 80 per cent of the population believes in witchcraft, simply has to practice a little sorcery." We are in for a long ordeal, Wallis says. If he is correct in his forecast concerning the length of the era of controls, then there will be extreme hardships for most citizens, yet incredible opportunities for high-risk profits at the same time, for it will not take more than a year or two before millions of Americans will realize their dependence upon the alternative (black) market. This means that there will be a growing market for goods and services within the middle class segments of the American population—the broadest segment of our population.

The strategy I am setting forth can meet the demands of both the short and long runs. But it should be clear that the longer controls are left on, the more difficult it will be for honest, law-abiding (or should I say legislation-abiding) citizens to survive without entering into voluntary exchanges on the alternative markets. For the short run (less than two years), the recommendations I make should carry through those who follow them without excessive legal risk. But if they remain in force for a decade or more, then all anyone can hope to do is to minimize his legal risk. He cannot avoid legal risk altogether.

I want it very clear from the beginning, however, that the strategy I am outlining here is entirely legal for the present. I am rewriting these words in late 1982. There are no laws on the books that would make any of my suggestions for present action illegal in any way. I am therefore not recommending that anyone break the law. What I

am trying to develop is an economic strategy that will permit people to prosper, or at least get by better than their neighbors, without resorting to illegal or questionable activities. But bear in mind that this strategy will become illegal once full-scale price and wage controls are imposed by the President and an acquiescent Congress. That is why present action is so imperative.

No one can follow all the suggestions I list. I am setting forth a program that must be adapted and applied to individual circumstances. It will work. It has worked in the past. But it will not do much good if none of the suggestions is taken seriously enough to apply. It is the *investment approach,* the way of *perceiving economic reality* that will get each family through the storms to come.

Nevertheless, I want to re-emphasize the fact that my strategy is a way to avoid participating on illegal markets in the future. Or should I say, my strategy minimizes such participation for those who merely wish to survive inconspicuously (a key word). The big profits in a world of price controls are made by those who do participate in the black market. Those who meet the needs of the buying public can make huge profits, for they fulfill an important social function by bearing risks and delivering the desired services. For those who wish to participate in future black markets in order to supply needed goods and services, I can only say, don't feel guilty. You are providing a very necessary service. But for those who are convinced that they shouldn't participate on black markets (meaning those who are comfortable today in a world devoid of controls that absolutely paralyze legal economic production), my strategy provides a legal alternative, if they act fast.

If my analysis of controls does make sense, then it is really suicidal, or at the very least foolish, not to begin to follow the strategy I present. Once again, it is not just what you don't know that can wipe you out. It is also *what you do know but refuse to acknowledge in your daily affairs* that can wipe you out just as fast, only you will have your own memory whispering in your ear: "You knew all this, dummy."

No doubt you are familiar with investment books. The chief problem that most people have with these books is not that the reader is unsure of the validity of the advice. If it were simply a question of ignorance, the reader could read more, look into things more deeply, and follow through on the leads provided by the book in question. Ignorance can be dealt with in a rational manner. The real problem

is a kind of *psychological paralysis* that hits most of us when we see an opportunity. In fact, it is this paralysis which makes possible far higher profits for those who have the same knowledge about the future but who are not equally inhibited. *The entrepreneur is willing to act.* He does not simply nod "ah, ha!" to himself, turn the pages thoughtfully, and then put the book down, forgotten. The first nine chapters of the Bible's Book of Proverbs instructs us to get wisdom. The rest of Proverbs is devoted to another lesson for us: get moving!

General Strategy

Saving: Discipline yourself to set aside at least 10% of your after-tax income, month by month, for a systematic program of investing in "hard" goods, or in education leading to your ability to repair such goods. Education is very important. It may be that you have little money but more time. Devote yourself to self-education if you have any talent whatsoever along these lines. Get into the public library and start taking out books devoted to auto repair, home repair, plumbing, electrical wiring, and so forth. This kind of investment is highly liquid, highly movable, yet (when necessary) relatively inconspicuous. *The best kind of capital is mobile capital, and education is the most mobile of all.*

The habit of regular saving is extremely important, both for the individual and for Western civilization. The foundation of modern mass production is the willingness of large numbers of individuals to forego present consumption, voluntarily, for the sake of a hoped-for future return. Saving is intensely *future oriented.* Furthermore, saving is an *ethical act.* It rests on an assumption, namely, that the future will not take care of itself, that people are personally responsible for their own welfare and the welfare of their families, and that they have a moral obligation to prepare for the future. Finally, saving is an *unnatural act.* You would think that as men grow more wealthy, they would save a greater percentage of their incomes, since each additional dollar would be used to satisfy wants of lower importance. After all, rich people do not starve, go hungry, or suffer cold. But the people of the United States today are saving a diminishing portion of their incomes as times get better economically. They become less responsible. They take the good times for granted. We are still the richest nation of the world, especially in the quality and spaciousness of our private homes, yet we save far less, proportionately, than the people of Japan, West Germany, and other less prosperous Western

nations.[2] *Saving requires discipline.* It requires it from an early age. It requires a future-oriented view of the world. It requires a belief in personal responsibility for one's actions. It is hard work, and it is absolutely vital for our survival as a nation.

Yet it is not enough to save money. It is not enough, in the oft-quoted (and miserably inaccurate) words of Eliot Janeway, to have six-months' income in your savings and loan account. Except for emergency money (probably under $2,000), few families that are not close to retirement (another evil) need that kind of money at their disposal. What you must learn today is to avoid money. Money is not capital in a world of price and wage controls. Capital will be hard goods, useful goods. Capital will be experience in repairing hard goods or in providing them in inconspicuous ways. You won't want money; you will want the things that money can buy today but won't buy after price and wage controls are in operation.

This is an extremely important concept in preparing for the world of price controls. You must rethink your usual equation of money and wealth. Under full-scale controls, money is less and less the sign or instrument of wealth. *Goods are the real wealth. Get away from money.* The love of money is the root of all evil; under price controls, it is also the best way to get wiped out. You want goods, not money.

Tithing: I realize that few, if any, books on investing recommend giving away money, goods, or services. This book breaks with tradition. In addition to saving at least 10% of after-tax income, I recommend giving away about 10% of your after-tax income. Those who have read the Book of Malachi in the Bible know why I say this. There is a relationship between the blessings of God and the willingness of men to honor the principle of the tithe. I have tested this principle in my own economic affairs, and I can say that it works. (Even if it didn't, it would still be an ethical obligation.) *Our goal should be the reconstruction of Western culture, and this takes money.* It takes donated money. It takes schools, hospitals, churches, the arts, and all sorts of charity-supported activities. If our main political and economic problem today is the huge, impersonal, ever-expanding

2. It can be argued that much of the savings of Americans — up to 50% — is going into "hard goods," small, underground economy businesses, and other places that do not leave records. I think the official figures understate the percentage of our income that goes into such investments. But, then again, foreigners may be doing similar things with a portion of their investments. As far as above-ground, traceable investments are concerned, Americans are very close to the bottom of the thrift list.

bureaucratic State, then *we must be prepared to take over many of the State's activities.* Either we pay for these activities and programs with money voluntarily donated to organizations that must give an account of their actions, or else we pay for them with higher taxes, and nobody is willing to take responsibility for anything. The discipline of the tithe is related to the discipline of saving. The sooner we and our children learn such discipline, the sooner we will see our hopes fulfilled. Resolve here and now to honor the principle of the tithe. The buck starts here. Give it away.

Timing: Watch very carefully for any announcement of an act of Congress which grants to the President the authority to impose price controls. This kind of legislation was passed just one year before Richard Nixon imposed the controls of August 15, 1971. It led me to state, in print, that Nixon would use this power. Of course, there need not be any warning at all. Nixon simply closed the gold window on August 15, without any justification legally. He didn't even declare an executive order. He just said that the U.S. would no longer honor its international monetary obligation to redeem dollars for gold. We live in a world of *much legislation* and *little law.* Excessive legislation leads to lawlessness.

However, when and if you see that Congress has granted the President such power, start to move fast. You will have to devote 20% of your after-tax income to buying hard goods. This is the minimum figure. If absolutely necessary, get a loan and start buying. Take an extra job. Do anything, but start buying. There will not be very much time to spare.

Which goods should you buy? As I never tire of repeating, those goods that are *highly price competitive,* with *narrow profit margins,* and that are sold in *high volume* to the *middle classes.* Why? Because these will be the first goods to disappear off of the shelves.

I keep thinking of the first presidential debate between President Ford and Jimmy Carter in 1976. I keep thinking of that $1.25 electrical part that failed toward the end of the debate. All America was watching, but America wasn't listening any more. For 28 minutes the sound was absolutely dead, even in the studio where they were debating. Finally, the newsmen had to string in new equipment. They never did replace that $1.25 part.

Now, imagine a world in which that $1.25 part really should be getting $2.50. But the government has outlawed price increases. It

has made the production of these parts at \$2.50 a criminal act. So what happens to the production and distribution of these "\$1.25" parts? They are sold illegally, or else they are not produced at all. Count on it. And if it is your company's \$5 million computer that needs that \$1.25 part, what happens to your job? Yes, they'll get the part, illegally, but how long will it take, with how many fouled up orders or directives?

Mark Skousen introduces his excellent book, *Playing the Price Controls Game* (1977), with this account:

> In August, 1974, I was travelling to Denver on a commercial airliner. Sitting next to me was a corporate executive in charge of purchasing computer parts for his company. Wage and price controls had recently been phased out, and so our conversation turned to the problems and distortions that had been created by Nixon's controls program. I expressed a number of reasons why I regarded controls as destructive, but as an economist my views were based entirely on economic principles rather than on any real experiences in the business world.
>
> In response, my acquaintance said, "Well, I'll tell you why I'm opposed to price controls." He then told me about the time he made a call to a supplier to obtain a vital computer component. Much to my seat-mate's consternation, his supplier announced, "Oh, sorry, but we don't make that component any more."
>
> "What!" exclaimed the purchaser. "You've got to be kidding. I simply have to have that part—why, without it the computer can't operate!" The supplier was sympathetic, but his hands were tied. "Look, it's simple economics. Under price controls, it just doesn't pay to make them any more. We concentrate on producing components with higher profit margins."
>
> I could see my friend was glad to see the end of controls. But what about the future? What would a computer-parts purchaser do if price controls returned? What steps would he take in anticipation of the next round of government price-fixing?
>
> "Well, for one thing," responded the businessman, "I certainly wouldn't depend on just one supplier for computer parts."

Speed is of the Essence

Once the "temporary price freeze" is announced, you're on your own. I can only give suggestions. You would be wise to go into debt at this point, although I do not normally advise debt. But this is a true emergency. You will need to step up your buying. Buy as much as you can. This means that your present level of indebtedness must

be reduced, in order to give you breathing room, or maneuvering room, when the announcement hits. As much as possible, *get out of all unproductive debt today.* Go in debt for a heavy duty washing machine, which is a labor-saving tool, but not a new T.V. Go in debt for tools of your trade, not a vacation. A washing machine, or a vacuum cleaner, or a good wood-burning stove are all capital goods. Avoid debt for purely consumer items, especially entertainment items. You can be bored with this year's line-up of "great programs" just as easily on a used black & white set as on a new Sony. You may want to buy your T.V. at a pawn shop or from a Good Will-type store.

What if you have never bought anything on credit? (Yes, there are such people; some of my readers won't believe it.) It is wise at this point to *establish a line of credit.* This will enable you to go into debt for long-term tools and equipment when the time for caution has gone. I would suggest the following strategy. First, set aside cash (meaning funds in a bank account or money-market fund). Then go out and buy a capital good of some sort on a 90-day credit line. Pay off the debt each month for three months. You might even consider paying it off a month early. You have the money in reserve, so it is not a true debt. You thereby establish your reputation as a reliable debtor. Having a Mastercard or Visa is useful for this reason, assuming you are not a debt junkie who cannot use self-discipline in structuring purchases. If you can get an American Express card, do it. If you can get a "gold" AMEX card, even better: it provides an automatic $2,000 line of credit. The day price controls are announced, you will want to buy long-term capital goods and survival items to the maximum allowed by the card or your expected future budget, whichever is less.

There is another factor to consider. *Wives need a separate line of credit.* If anything happens to the husband, the wife needs her own credit cards. These should be applied for independently. Do not have the husband co-sign anything. Bills should be sent to the wife in her name. She needs her own checking account for paying some bills. Legally, the credit card companies are not allowed to refuse credit to credit-worthy women just because they are women. Working wives should insist on having totally independent credit sources. See the book by Elizabeth Block, *A Woman's Guide to Credit* (Ace Books, 1982). But what is true for a man is equally true for a woman: *if you are a debt junkie, avoid the cards.*

When the announcement of controls or guidelines is made, you are literally racing against time. The time will have come to start buying and hoarding (saving) in earnest. There will be no more doubts in the minds of those who are familiar with price controls and their effects. They will be buying heavily. They will be getting ready to become suppliers at above-legal prices. There should be no more doubts in your mind then. Speed will be imperative, really imperative.

These percentages are arbitrary. How can I be sure that 10% or 20% will be just right for you? But I do know that 10% is better than 8% or 1%. I do know that the kind of world that is on its way has got to be viewed from a new angle. I do know that most people will not see it from the proper perspective until it is far too late to take advantage of the wide variety of producers' goods that are available on the pre-price control markets. These are minimum survival figures. These are what you have to have to get by comfortably for a year or two. The longer controls stay on, the higher the percentage of present saving (hoarding) should be.

I am increasingly convinced that the controls will be on for a minimum of five years. I think a decade is not out of the question. I dearly hope that our political system would reverse the effects of the controls after a period of ten years. But I am not really convinced. *We are being engulfed by the politics of envy. Controls are ideal devices for bringing out the envious side of mankind.* There are great winners, those who are participating successfully on the illegal markets. They become easy scapegoats for the politicians and bureaucrats. They are too easy to blame for the hardships of others, for the shortages, for the economic dislocations. And there *will* be dislocations. Men who participate on the markets as little people will not shed any tears when their trading partners — the most successful trading partners — are caught and sentenced.

This leads to another rule: if possible, *trade only with those who are in a comparable income bracket.* Of course, you can trade with someone who is richer, if he is so unwise or so trusting of your integrity to trade with you, the little guy. *But don't trade down socially, if you can avoid it.* Don't let the feelings of envy get aimed at you. If you do trade down, then do so humbly, quietly, and above all, inconspicuously. Dress plainly. If you're smart, get rid of the outward signs of wealth the day controls are imposed. Sell that home in the ritzy section of town if you have one. Sell the Mercedes. Get a small

farm in the country. But don't be visibly prosperous. Keep your assets out of sight. Do not "buy upward."

I realize that this is strong medicine. A rich man is unlikely to take my advice. But it is good advice for an envy-dominated era. The idea is to pressure and expand your capital during a period in which other men are going bankrupt or are being forced by circumstances to liquidate assets at distressed prices. But when they pass a capital tax, as they have in European socialist country after country, it will be far better to have your assets hidden. These will be sharply graduated taxes, "wealth" taxes, envy-designed taxes. Envy is loose in the land. Maybe you don't have the time or inclination to read Prof. Helmut Schoeck's great book, *Envy* (Harcourt, Brace, 1969), but you can take my word for it: *socialism is at root the desire to tear down all the signs of another man's success. It is the great social destroyer.* The bigger you are, the more likely you'll fall. Or more accurately, the bigger you appear to be. When they can't get deeply enough into your pocket with income taxes, sales taxes, capital gains taxes, and estate taxes, then they will tax whatever you have left over that is visible.[3]

Barter Now

Barter is coming back. Several firms have been established in the last few years that supplement the money-denominated markets for goods and services. If you have a business, you should know about these programs. If your area doesn't have one, here would be an excellent business to run on the side. In any case, it will gain valuable experience for you and all who trade through any such organization.

Say, for example, that you have a tire store. You join one of these barter societies. Someone who is already a participating member comes in. He buys your tires. But instead of paying you money, he pays you in certificates that can be used to buy products from another member of the group. The larger the membership, of course, the broader the market. The broader the market, the more specialized and productive the labor is. Participants have a wider selection to choose from.

Maybe you want a new suit. You go in to the man who sells clothes, give him your certificates (earned from the man who bought

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3. See my book, *Successful Investing in an Age of Envy* (Fort Worth, Texas: Steadman Press, 1983).

the tires from you) and buy the suit. This is especially good for a man who (wisely) is reducing his cash flow and laying up inventory. He is getting into hard goods or direct services, yet it isn't eating into his cash. His cash can then be used to invest in even more hard goods for his business or family.

There are even some people who might fail to report the full retail value of such exchanges to the tax authorities. I do not recommend this: the IRS looks for such evasions.

Don't try to get rich by starting a barter company. And don't try to beat the tax man. Most importantly, don't invest in a franchise deal that promises to make you rich by avoiding the tax man. There are too many hustlers franchising barter companies these days. Let the investor beware. I can recommend one firm as an example of what can and should be done with a barter company:

Business Owners Exchange
Pentagon Office Park, Suite 100-B
4901 West 77th Street
Minneapolis, MN 55435

For professional consultation in organizing a barter society, Mr. Jesse Cornish, the creator of Business Owners Exchange, is available on a retainer fee basis. Paying a fee to a successful professional is generally preferable to purchasing a franchise, which several organizations sell. You can contact Mr. Cornish by calling this toll-free number: (800) 328-1860. (He also sells gold and silver coins.)

The quicker you and your neighbors get used to the idea of barter, the better off your community will be. In California, the swap meets that are held in drive-in theaters on the weekends have become meccas for sharp traders. There is no reason why a local organization cannot imitate the success of the West Coast swap meets. (Weather is on the side of the Californians, of course.) The one problem with organized barter societies for the future is the fact that they do leave records. There are charges for each trade, and the tax authorities can compute the value of the exchanges by using the 7% or 8% fee charged by the firms. Still, participation now can introduce you to people in the community who are barter oriented. This information will be very valuable in the future.

Conclusion

The idea is, simply, get started. Get used to the idea of innovation. Get used to the "feel" of face-to-face exchange. Get used to the idea that "money talks." It does, for the present. But someday, it will only whisper.

One thing, though. You should have confidence in yourself. You'll make mistakes, but you have knowledge now that most people don't have. That knowledge is your source of future profits. Have confidence, get busy, and help to rebuild.

18

A SECOND JOB AS A SAFETY NET

One of the most difficult tasks of a serious investment writer is to convince his readers that certain steps should be taken in their financial lives in order to protect themselves from a looming disaster, or to take advantage of a new opportunity. I have become convinced that traders' sheets provide information that only a small percentage of the readers ever really act upon. I have concluded this by watching the results of specific recommendations. I remember one popular letter's advice to short the Swiss franc in January, 1973, just before the massive increase in the franc's value when the Swiss floated their currency in order to escape the panic run out of dollars and into francs. Had any trader taken a short position on margin in January, 1973, the one-day leap in the franc would have wiped him out completely. Yet the letter in question still prospers. People take trading sheets for many reasons, but given the volume of the specific recommendations, it is unlikely that any one recommendation will be followed by a majority of the traders who read a particular sheet. In fact, the more recommendations made by a sheet, the less likely that any single subscriber will be wiped out. At the same time, no single trader is likely to profit from those recommendations that do prove accurate. Sooner or later, letter writers who provide many recommendations per week experience a kind of temptation peculiar to the profession: the "filler syndrome." Just say something eye-catching, since so few will act. People seem to want zippy copy more than they want specific recommendations. (I'm speaking here of the more apocalyptic letters, although I suspect that the same problem holds true for the standard market letters.)

With studies like mine that are geared to long-term planning rather that short-term market recommendations, the problem of convincing readers to act is somewhat similar. No single family can afford to take every suggestion, but ideally every suggestion, five or

ten years down the line, ought to produce profits (or avoid losses) for those who took action, given the risks of any human action. Each reader should get a few ideas out of this book that warrant its price. Thus, not every recommendation should be acted upon by every reader. This is analogous to the multiple tips in traders' sheets: no one actually follows every recommendation. But there is one crucial difference: the reader may not be sure of the validity of a suggestion for several years. This is why trust is so important between writer and reader. This is also why the logic of a major (expensive) recommendation has to be spelled out.

A Family Safety Net

Because of the disruptions that would appear to be inescapable over the next five years, no man can be really certain that his present occupation will insure him against all the potential losses that could come upon him. Civil servants enjoy job security, but not inflation security, and especially not repressed inflation (controls) security. Salaries may come, but purchasing power almost certainly will go. Credit crunches are produced either by tight money policies or by easy money policies that produce price inflation loan premiums that in turn smash into state usury laws; these crunches can bring a company to a grinding halt. Lay-offs take place in boom times if a particular firm gets trapped. As I wrote in the 1977 and later editions of this book: "The whip-sawing effects of the boom-bust policies of the last decade are probably going to increase after 1977, and it takes skilled managers to deal with the next crisis rather than the last one. Your manager may goof." So far, I think this warning has been correct.

Many families have both husband and wife working. If the family's expenditures are not pushing tightly against income, and if the two wage earners are unlikely to be fired simultaneously, then the family has a cushion. But how many families have much latitude? And the costs of working parents to the family may not be seen for many years, until the children hit their teens. Unless the wife's job keeps her close to home, the personal family costs may prove to be too high in the long run.

This leaves the husband in a dilemma. A second job may drain him physically or financially. It eats up his time. The obvious source of more time—unplugging the television set—is a drastic step for most families. Yet today it is very important for a man to have a

second source of income besides his first job. The psychological safety net of a second income is something that few men experience, but in times of disruption it should not be dismissed lightly. We always tend to accept the good times as normal, since our income rises as we mature in our productive economic years. But the normality of good times is under fire all over the world.

What Else Can You Do?

The essence of the disaster we face, economically speaking, is the over-specialization of modern life. The moral faith which undergirded this massive expansion of human productivity and specialization is steadily eroding. Envy, the statist abrogation of the right of contract, the inflation of the money supply, the redistribution of wealth, and the inflation-produced boom-bust cycle have now brought us face to face with a horrifying thought: Can the extension of the division of labor, and therefore rising real income, be continued? If the monetary unit is destroyed, can the division of labor even be maintained? This is the question Prof. Hayek keeps bringing up, much to the disgust of the Keynesians. (See Chapter 3, "Inflation and Unemployment.")

Not only can each man do something else for a living, he may very well have to over the next decade. The best thing that a man can do for himself, given this possibility, is to seek out that alternative employment which suits his skills, and which is likely to be in demand in a controls-induced shortage economy, and then begin to enter that field now, slowly, thereby lowering the costs of transition later on. The wisest employment is that provided by many buyers, so that no single source of revenue can make or break a man's business, should it be turned off. *The broader the market, the safer you are.* However, it might be wise to develop that broad market within a *local geographical area,* for reasons which we have gone over in earlier chapters: feudalization of the economy, breakdown of outside suppliers, irregular mail service, etc.

Peter Weaver has written a helpful little book, *You, Inc.* (Doubleday Dolphin Book). Weaver shows how he broke out of his salaried, safe position by becoming a writer, but many of his reasons for breaking out and his recommended steps for doing so are quite applicable in other professions. There is boredom associated with dead-end middle management (age 40 +). There is the risk of putting all your eggs in one corporate basket. There is the psychological problem of over-dependence, which in turn can lead to killing stress.

There is the stifling atmosphere of any bureaucracy. Your ideas get blocked. "Your soul gets scarred and shrivels a little. Your intellectual growth withers. You can't even make your own mistakes." Finally, there is the overwhelming danger to the older man of the retirement trap. Inflation eats away his pension, assuming he has been able to collect his pension (and pensions are a major Achilles' heel of the American economy, both public and private ones). The boredom can kill him. The sense of loss can break his spirit. Therefore, Weaver argues, a man should try to break free, if only part-time.

St. Paul, some of you may remember, was a tentmaker (Acts 18:1-3). His independent source of income gave him a measure of independence from the churches which he advised (II Thessalonians 3:7-9). Not being in the pay of any of them, he did not need to bend his preaching or admonishing to suit the pleasure of his listeners. But he did have to meet the competition in the tent market in order to preserve this ecclesiastical independence, and he also had to labor day and night, as he reminded the church at Thessalonica. He was independent, but not at zero price.

Preliminary Steps

First, discuss the idea of a second occupation with your wife. There are too many risks for you to go out on your own "cold turkey." But if she can see that you and she need the security of a second income, then she will better understand the costs she will have to make. Second, don't expect to be able to make all your decisions immediately. Most new businesses fail within the first five years. They are almost invariably undercapitalized. The less capital you have, the more slowly you should embark on a new calling. You cannot afford dangerous mistakes, so reduce the danger by starting slowly. Third, avoid debt.

Psychologically, Weaver says, the best step you can take is to decide on a company title and go down to your local bank and deposit $50 or $100 or whatever in a special bank account for your business. Get that checking account going, and never touch it except for business affairs. If you need a file cabinet (you will), use your business account. Get in the habit of regarding this account as strictly business. Any money coming into this account from sales must also be regarded as untouchable until the business becomes profitable. If you have to take an extra job to finance the new business, there will

always be a temptation to spend the money. Parkinson's Law takes over, as expenditures rise so as to absorb all new income. But the key is the first step in establishing a visible symbol of your intentions: a separate business checking account, if it's not a cash business.

Sometimes you may have to sacrifice your present occupation's opportunities in order to gain your freedom. If you want "out, not up," writes Weaver, this may mean turning down a promotion or transfer. You may even have to take a part-time job to finance your new venture, and this could cost you your regular job. But even this seeming disaster might leave you with more time, which is the crucial capital resource in the beginning.

"I'm not saying you should refuse promotions or more money," he writes. "Just remember: Rent them your body for a while but never, ever, sell them your soul. While you are renting your body, keep your mind on extracting portable skills or a profession that you can take with you when you make the break into your own business. While building up these skills, you should keep a little file of ideas for your side venture." Portable skills are a form of portable capital, and there is no better form of capital. It is untaxable, it cannot be redistributed by governmental edict, and it is invisible.

In some cases, you will probably find that work in your regular job is improved by your new project. I found this to be the case when I began to publish my bi-weekly economic newsletter, *Remnant Review.* I discovered that by having to keep up with the economic news, the relevance of my writing and speaking for the non-profit foundation I was working for when I began the newsletter improved considerably.[1] Some employers might not be very enthusiastic about the idea, however. Obviously, a person with outside income is going to be more independent in his work at the office, and some firms are so bureaucratic that the managers resent signs of independence. They want safe, docile employees. That's their mistake. They lose their best employees this way, or else stifle them into lower productivity.

Optimism concerning one's future (if not transferred blindly to

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1. The Chalcedon Foundation. Prior to that, I have been employed by the Foundation for Economic Education, in Irvington-on-Hudson, New York. The policy of Leonard Read, the president of FEE, was to require all employees to give all money to FEE that they earned from speaking or writing, even if done on their own time. Needless to say, this served as a disincentive to do extra speaking or writing. I began *Remnant Review* about 16 months after I left FEE. Income ceilings reduce output. Mr. Read never really understood this basic free market principle. "Share the wealth" schemes don't work either.

the economy in general) is a kind of internal incentive to increase production. *But self-confidence comes slowly, or should; careful planning and practice should precede any full-scale operation.* Avoid debt until the company is really on its feet; avoid debt entirely, if possible. Build up your new market slowly, unless you have a product so good that direct advertising is almost certain to create an immediate profit, and which requires a low capital investment to produce. Too rapid growth can kill a company. This is why a service is less risky to sell than a product in most cases.

Starting a Family Business

"He who does not teach his son a trade teaches him to steal," says an old Jewish proverb. Yet in the modern economy, few men can teach their sons their trade. Their trade is too specialized, and it requires professional training, or trade union approval, or some sort of licensing, or a work permit. In short, *salaried men do not work with their sons.* Moreover, the old Puritan practice of sending sons to an apprentice, and taking in other men's sons as apprentices, has also disappeared, and *with the disappearance of apprentices we have also witnessed the disappearance of the old crafts.* This has involved a cultural loss to society, but in a time of shrinking division of labor, it may well involve far more than cultural loss.

The advantage of a family trade of some kind is that a man can pass along his *secondary occupation* to his sons or daughters. While they may not take up the trade as a full-time occupation, they have been provided with a kind of employment insurance. The *habits of discipline,* so crucial for successful entry into the marketplace, are established early. A *sense of family involvement* is also created—not some sort of makeshift togetherness, but community based on shared goals and shared labor. The breakup of the family unit is one of the primary causes of the social crisis of our time. The returns to a family business could be far more than monetary.

One of the most disastrous side-effects of minimum wage laws is the denial to ghetto youths of legal access to the low-paid jobs that might otherwise have taught them regular work habits. Without these, they are almost as crippled as they would be if they could not read, which many of them can't. But minimum wage laws do not affect pay scales of family members in a family business, which is one great advantage the sons of farmers have in this country. They learn how to work. This is no small accomplishment. Businessmen are

hard-pressed to find young men who can handle the discipline of labor. This is going to get worse, since today's low birth rates will put tremendous pressure on businesses like the fast-food industry that rely heavily on young, minimum-wage employees. A good source of labor talent for such businesses will be the graduates of the Christian school movement, since there is greater discipline and more emphasis on honesty in these schools, not to mention better training in the three R's, than the average public high school offers. This is one reason why the graduates of unaccredited Bob Jones University are sought after by American business. Bob Jones students know how to work hard, and that is all the accreditation the school needs.

Children have become an economic burden in our day. It costs anywhere from $25,000 to $100,000 to rear a child today, and this is not counting the economic losses to the mother who stays out of the labor market for two or three decades.[2] As a result, the size of families has dropped within the middle class and upper class populations. We are literally seeing a kind of self-extinction of the most talented families—a seemingly rational economic response to the costs of specialized education. But socially, this response is more questionable. I keep thinking of the observation made by the Jewish mathematical genius, Norbert Wiener, concerning the difference between the Jewish and the medieval Christian view of learning: "At all times, the young learned man, and especially the rabbi, whether or not he had an ounce of practical judgment and was able to make a good career for himself in life, was always a match for the daughter of the rich merchant. Biologically this led to a situation in sharp contrast to that of the Christians in earlier times. The Western Christian learned man was absorbed into the church, and whether he had children or not, he was certainly not supposed to have them, and actually tended to be less fertile than the community around him. On the other hand, the Jewish scholar was very often in a position to have a large family. Thus the biological habits of the Christians tended to breed out of the race whatever heredity qualities made for learning, whereas the biological habits of the Jew tended to breed these qualities in. To what extent this genetic difference among the Jews supplemented the cultural trend for learning among Jews is difficult

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2. Counting the forfeited earnings of the wife, the cost could be $300,000 for a single-child family.

to say. But there is no reason to believe that the genetic factor was negligible. I have talked this matter over with Professor J. B. S. Haldane [the famed biologist], and he certainly is of the same opinion."[3] Genetically, the Jews' marital policy favored them over the Catholics. What we see today is analogous to what the later Roman Empire in the West experienced: a population boom among those on welfare, and a declining population among urban, tax-paying classes.

A small family business, even if it is initially unprofitable monetarily, can produce long-term family benefits, so long as the budding entrepreneur is careful not to risk too much of his capital in the early stages. Capitalize the business slowly, using "spare" time if there isn't enough money available.

What Kind of Business?

The first and most important requirement is personal. Do you think you would enjoy the work, even if it paid very little for a considerable period of time? Is the joy of doing business worth the sacrifices and risks? This question is ultimately a religious question about your purpose, skills, and attitudes of life. You have to want to do this second business. If you don't, you will give up too easily. Worse, you might even become too successful, and then you will wind up as your own organization man, falling right back into the bureaucratic trap you are trying to escape.

No matter what you get into, there will almost certainly be a trade association around that can help provide you with such benefits as group insurance, trade papers, guidebooks, newsletters, and other important information, including professional education opportunities. There is a book listing these, *National Trade and Professional Associations of the United States*. There are over 4,500 of these associations. If your local library doesn't have it (including the local university's business education library), it can be ordered from Columbia Books, 777 14th St., N.W., Suite 236, Washington, D.C. 20005: $35.

One benefit you should look for, though not make a primary asset, is whether the second business is contracyclical to your primary employment. Does it boom when your regular business does, and

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3. Norbert Wiener, *Ex-Prodigy: My Childhood and Youth* (Cambridge, Massachusetts: The M.I.T. Press, [1953] 1966), pp. 11-12.

fall off when your regular business does? If so, be careful; the heaviest demands will be placed on you at the same time, yet the "insurance policy" aspect of the second business may evaporate. If you can find a "sales-repairs" tandem, you have a strong pair. When recession hits, and sales fall off, people will need to repair their existing equipment. A man can cut down on his sales job and concentrate on repairs. Either can be the primary job, but it would seem more likely that those who read a book like this one are more apt to be salesmen than repairmen. An excellent opportunity for a salesman would be to train in minor repairs in his company's service program if he sells durable goods. The firm may even finance some or all of the education costs. This will make him a more desirable salesman—buyers worry about machines that break down, and a salesman who can make minor repairs has a real advantage—and at the same time provide him with a portable skill. But if you do this, be very careful not to take business from the company's service department with your own moonlighting operation. *Do not create conflicts of interest with your present employer.* This is a fundamental general principle for all moonlighters. Learn what you can from your present employer, but develop your own contacts on the side.

The Harried Professional

The entrepreneur is never able to rest. (A Christian or Jewish businessman takes rest on the sabbath, but it is an act of faith; his time is not wasted, for he is giving God what is due, and God will uphold him.) He always can learn more, plan better, buy cheaper. His business eats up his time. (This is why men pay good money for newsletters. My readers, in effect, are disciplining themselves to read the equivalent of a book each year, but in digestable portions.) He thinks he cannot possibly spend enough time to learn a new trade and still perform well in his business.

This may be true. If so, the businessman absolutely must find other men with skills who need a silent partner. Look for honest, reliable men who are willing to sacrifice for their trade. Then find a trade which is contracyclical to your own business that will be populated with a few such men—the fewer the better—assuming that you can pick out the good ones. I would like to say that a church is a good place to start recruiting, but I have seen too many Christian businessmen who have little regard for paying debts on time. But if there is a tradesman in a local church who has stayed out of

debt, but who now needs a lot of money to launch a new part of his business, he might be a good risk. But in any case, a portion of your capital should be put into *men* rather than pieces of paper. In a time of disrupted capital markets, it is the *character of local tradesmen* that will count a great deal.

A partnership is difficult to break when it becomes successful. Have a clause written into the original contract allowing one partner to buy the other's share at a price to be offered by the disgruntled partner. The other partner has the option of buying the first one out at that price. This keeps the offer honest. Either can buy the other out, so the man who wants to get the other man out must offer a fair price to avoid a counter-offer to buy him out.

Another basic rule: the "silent partner" should have the veto power of any increased indebtedness in the partnership or corporation. Perhaps the strongest argument in favor of a small corporation rather than a partnership is the question of debt. In a partnership, both partners are legally liable, personally, for the debts of the business. If one partner runs up huge debts, the other partner's solvency is threatened. It is a violation of the old biblical rule not to co-sign for (become surety for) anyone else. Both partners should have to co-sign any notes. Partnerships are very risky unless they are debt-free. *In no small business should one partner have the right to indebt the business without the other one's permission.* This must be in writing in the partnership or corporate By-Laws.

The ideal second job for a really busy businessman should have something to do with his hobby. If he has gained knowledge here, and if the time spent on this hobby does not seem to be stolen from his business, then he may be able to transfer his hobby into a second business.

You must know yourself. You must know your strengths and limits. You must know some of the limits of the bureaucrats of the proposed New World Order, which is going to be the familiar Old World Disorder. If you cannot move to a small town, then begin to prepare yourself for productivity on your block in a big city.

If you go ahead on this project, be sure to buy a copy of Don Dible's book, *Up Your Own Organization* (Entrepreneur Press), which is now available in paperback. It is sold in the B. Dalton bookstores.

The Sure Thing

Is there any occupation today that is virtually guaranteed, given

competence and honesty? I have thought it over, and I think there is one. If you have the skills, become a locksmith. Invest in a trade that has subsidies, 24 hours a day. "Invest in crime; it's going up." The skills are portable, the demand is growing, and it combines both sales and repairs. There are locks to match every man's skills, and buyers of services at each level. This skill is usually learned as an apprentice or through mail-order correspondence courses. This trade could be combined with other aspects of "home defense" and business office defense: sales, of burglar alarms, fire detectors and extinguishers, etc. I'd rather have a locksmith for a son than a sociologist. I want to eat in my old age, not read the results of surveys. Training is available from:

(Evening)
California Institute of Locksmithing
14721 Oxnard St.
Van Nuys, CA 91411
Tuition (late 1982): $1,825
(213) 994-7426

(Correspondence)
Locksmithing Institute
1500 Cardinal Dr.
Little Falls, NJ 07424
Tuition (late 1982): $360
(201) 256-4512

Should You Incorporate?

I'm not a big promoter of Subchapter S (small business) incorporating, although there may be some advantages for businesses netting under $50,000, unless partners are involved. Then I think it is better than a regular partnership. If you do decide to go the corporation route, the cheapest way (which is not necessarily the best way) is to use the services of Ted Nicholas' Corporation Company, a firm that will incorporate you in the state of Delaware for under $100. Your home state may require additional payments, but Delaware corporations are unbelievably loose. You can designate your corporation as a firm engaging in any lawful activity, and you only need one director. For a $25 annual fine, you can even neglect to file an annual report to the state. Nicholas' book provides all the necessary forms: *How to Form Your Own Corporation Without a Lawyer for Under $50* (Enterprise Pub. Co., 1300 Market St., Wilmington, DE 19801: $15.00). I would still recommend a lawyer or CPA to help you set it up. You might also want to read Judith McQuowan's book, *Inc. Yourself* (Macmillan, 1977).

A major advantage of a sole proprietorship, as distinguished from

a corporation, is that the business can pay salaries to the wife and children (under age 21) without having to pay the Social Security tax.[4] A disadvantage is that a sole proprietorship cannot pay your family's health insurance premiums on a tax-deductible basis. A small corporation can. This can amount to well over $1,000 of tax-free "income" if you buy a comprehensive policy, such as the one sold by Blue Cross-Blue Shield.

There is one book which all prospective entrepreneurs should buy and read very carefully. It is Richard White's *The Entrepreneur's Manual.* It is a detailed study of how to make money and avoid losing money. I know of no better introduction to small business. Order from Chilton Books, Radnor, PA 19089 ($17.50, plus $1.75 postage & handling), or order from your local book store.

Conclusion

I understand that the idea of starting a small business is foreign to most people. Most people prefer to avoid visible risk, and to go about their daily lives as if there were no opportunities available and no crisis looming. People are habit-controlled creatures. They are content to stay in a rut.

Nobody ever told me how to run a business. I never took a business course in college. Nobody ever taught me advertising. Nobody ever taught me how to write newsletters. Yet today, nine years after I started *Remnant Review,* I am mailing anywhere from a million to two million pieces of direct-mail advertising a year, and this may go higher in the future. I am having more impact on how people think than I could have had if I had remained an ivory-tower scholar—the profession I was trained in. Starting a business made my life.

I am not saying that everyone can be a success as a small businessman. I don't think everyone can become successful in business. What I am saying is that *under price and wage controls, no one who is salaried can be successful,* unless he is in the top 2% of the population in terms of income before the controls are imposed, and even in this instance, he will have trouble with the controls. For those who could be successful in a small business, but who never try, their hesitation will thwart their talents. For those who are not well equip-

4. Internal Revenue Service, Circular E, *Employer's Tax Guide, Publication 15* (Nov. 1976), p. 13.

ped, or who select the wrong business to go into, they still will develop skills that will be useful under controls.

To become totally dependent as a salaried worker is unwise. You simply have to get something going on the side. Now is the time to start planning along these lines.

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THE QUESTION OF TIMING

The question of timing is crucial for any entrepreneurial decision. The source of all profit is *successful forecasting* and *efficient planning* in terms of an accurate forecast. But there are many different ways to measure profit. In fact, the whole accounting industry is in an uproar because of continuing debate over the proper way to record profits in corporate reports. In the final analysis, profit must be determined by the acting individual. What does each man think he should do with his assets in order to better his condition? This is what all of us must ask ourselves constantly. We change our minds all the time, sometimes in response to losses, but sometimes in response to what we had thought would be true profits—results that we wanted to achieve that turn out to have been unfulfilling. I have to stress this point: *the ultimate profit is not necessarily or even usually the positive results on a corporate profit-and-loss statement.*

People are willing to spend money in order to make money. They buy information that they believe will help them to make more money in the future. I am all in favor of making money. But we have to bear in mind that in a era of seriously enforced price controls, "making money" means *avoiding* money. When we say we want to make money, we mean we want to have more goods and services, more power, more of the things we want to the end of a period of time. We equate making money with gaining assets. That is a kind of mental shorthand that is reflected in our language. But in an era of controls, we have to beware of traditional language because we have to rethink our activities in the market.

The reason why controls are demanded by the public is because people are too dazzled by language and inaccurate perceptions based on a convenient mental shorthand. Prices, denominated in a particular monetary unit, are rising. Instead of questioning the monetary unit, most voters look at prices. The problem is seen as being the

problem of decisions made outside the world of money. Someone is greedy, someone is a monopolist, businessmen are crooks, someone is gouging the helpless public. Thus, prices have risen. But the problem is not greed, monopoly (at least business monopoly), crookedness, or gouging. *The problem is monetary inflation*—an ancient misuse of government monopoly. But people refuse to see this. So they call for price and wage controls. An error of economic analysis, coupled with rampant political envy, has created a situation that compounds the economic problems. People blame the traditional enemies, such as big business, when the real problem is political.

By now, this is familiar enough to my readers. But we, too, must take care not to become entangled in concepts and language that are no longer accurate in the new world of price controls. We have to time our actions in terms of a new set of external conditions. We will no doubt make a lot of mistakes, but we have to make decisions, and we might as well get our language cleaned up in advance. We may say the old words, for the sake of convenience, but we must know what we really mean.

What I mean is simple: do not expect the Federal government to solve the inflation problem. It is the cause of the problem.

Shortages and Fear

The summer of 1979 brought frightening gasoline shortages to the major cities of America. The gas lines began in California. (In 1974, California was one of the last regions to suffer.) In rural areas, and even in moderately large cities, there were no visible lines. In Los Angeles, San Francisco, New York City, Washington, D.C., and even in Houston, people spent hours waiting in long lines to buy gasoline. When Americans cannot buy all the gasoline they want at the posted prices, they get angry. They panic. They call for government action.

One fact should be understood from the beginning: *shortages are the results of specific economic and political policies.* Scarcity is a fact of life. Shortages are not. Scarcity means only that at zero price, there is a greater demand for most goods than there are supplies to meet that demand. So economic goods command a price. A shortage results when prices are closer to zero than the market would otherwise dictate. If you want to clarify the nature of a shortage, so that you will not be misled by experts in rhetorical manipulation, you need a

rule. The rule is simple enough. Never, ever think the word "shortage," let alone utter the word, without keeping this qualifying clause in the back of your mind: "shortage at some price." *There is no such thing as a shortage, as such.* There are only shortages of specific goods or services at some lower-than-market-clearing price. When there are people willing to buy at a particular price, but not enough supplies to meet their demand, then a higher price is called for in order to clear the market, i.e., equalize supply with demand.

Consider the grim reality of modern economic life. The Federal government has a monopoly of dollar creation, at least inside the borders of the United States. It shares this monopoly with the Federal Reserve System and the nation's commercial banks. When the government creates money by selling debt to the central bank, the boom-bust cycle is set into operation. The boom leads to rising prices, as people compete against each other to buy goods and services. They use the newly created fiat money to make their bids. Prices rise.

The government likes the boom but hates rising prices. Rising wages are politically acceptable, and they also lead to higher income tax and Social Security tax revenues. The boom can only be cooled by the stabilization of money, or at least by a failure to increase the rate of money creation. To stifle price rises, the government must follow policies that lead to an economic slowdown or recession.

Bear in mind also that people are short-sighted. They are never quite certain just what it is they want the civil government to do. (My answer, of course, is simple: less.) When prices are rising, they worry about inflation. But when unemployment starts up, in response to inflation-fighting monetary policies, they cry out for government to put an end to unemployment, too. The problem is, basically, that once the fiat money-induced boom has begun, there is no known way to obtain both falling prices and very low rates of unemployment until the market has had time to adjust to the new rates of monetary expansion. This adjustment period is called "recession" or "depression." The public is not sufficiently confident in the ability of free market forces to produce economic growth and stable (or even falling) consumer prices. They no longer trust the Federal planners, but they still don't trust the free market. They don't know what to believe, so they do what is familiar. What is familiar is to call on the government to repair the mess created by earlier government decisions.

The boom-bust cycle has been going on for several centuries, but the public simply cannot locate the source of the trouble, namely, the monopoly of money creation in the hands of the government. So they demand short-run solutions. What the government is capable of providing is only short-run responses, or multiple responses that in many cases are in conflict with each other.

Eventually, both the voters and the politicians get tired of the never-ending swings between higher prices and unemployment—swings taking place at ever-higher levels. The trouble just will not go away. People start lashing out at real or imagined enemies: the Arabs, the oil companies, the speculators, the apartment house owners, the supermarket managers, the truckers, and even (miracle of miracles) the trade unions. People decide that the best way to solve the problems of the market, meaning the inflation-buffeted market, is *to bang a few heads.* Whose head is the preferred one to bang? It isn't easy to predict in advance. It depends on the timing. Who is being singled out by the news media as this month's "public economic enemy number one"? He will be fair game when the axe falls, when the President is forced to Do Something Creative and Forceful.

One of the most fearful aspects of recent years is the willingness of the public to expect forceful actions by the President. The drift of modern political life has created a monster. Men have been led to believe that centralized political and economic power is creative, only to discover later on that central power means a massive bureaucracy and economic strangulation. They have not learned their lesson . . . yet. President Carter was unmercifully critized by the American press and by editorial writers for his seeming indecisiveness during the gasoline crisis of July, 1979. His energy policy advisors could not agree on the proper policy, so he cancelled an announced speech on energy. Why not? Why come before the public and say nothing? Of course, it would have been wiser never to have announced the speech. This seeming indecisiveness cost him dearly. The public has been promised miracles by four decades of political scientists, messianic politicians, socialist and Keynesian economists, and most textbooks in the social sciences. That religion, always a false one, is steadily revealing its fraudulent nature. But the public is now savaging those "priests" who are trying to explain away their inability to produce bread out of stones—the trick they had claimed for years to be able to accomplish.

If you are trying to deal with the economic future, be sure of one thing: *men do not abandon a political religion easily.* In time of peace, they seldom abandon it at all. Only crises can force the hands of the false priesthood. Only economic, military, or social catastrophes are sufficient to get the public to change its collective mind. The trouble is, you and I are trapped inside the arena in which the crises are being turned loose.

What will the government do? Inflate. What will happen to prices? They will keep rising. What will the response of the public be? Outrage. What will the government then do? Lots of things, almost all of them disastrous. You must watch very closely to see the signs of impending doom: the coming of controls.

When you start looking for the "key" sign to watch, you are probably making a mistake. *There is no sure-fire, universally valid key economic indicator of the future.* If anything, there are too many to watch, and sometimes they seem to be contradictory. *There is no known scientific formula for charting the economic future.* What is important is that you be aware of several economic factors that seem to be reasonable indicators of a forthcoming political decision. Monitor them carefully. Then guess. An informed guess is the best you can hope for.

The Signs of the Times

Monetary inflation is always a good place to start watching. The problem for most of us is that these statistics are available only intermittently. On the other hand, these figures don't have to be monitored weekly. Serious readers can subscribe, free of charge, to the publications of the St. Louis Federal Reserve Bank. The weekly publication, *U.S. Financial Data,* provides a running commentary on monetary developments. Some people may wish to order its *Monthly Review,* which offers semi-technical articles of importance. (Write: P. O. Box 442, St. Louis, MO 63116). If Money One (meaning checking accounts plus currency in circulation) begins to climb over several months' time at rates approaching the double-digit level, be sure to keep monitoring statistics. It may take six months, or it may take a year, but price increases will follow on the same order of magnitude. (Also monitor the "Adjusted Monetary Base.")

Price inflation has a psychological impact. The 10% figure is significant politically. The commentators will start writing about price inflation once it goes above 8%, but 10% will be headline news.

This will bring out the consumerists and the do-gooders. Something has to be done, they will shout, except they won't be very sure what. So the old political game will begin again. Yes, we "partners"—government officials—told those greedy people not to raise prices. No, it didn't do any good. Yes, we have to do something. No, voluntary guidelines didn't work. Yes, price controls have failed in the past. No, it won't do to sit quietly on the sidelines, shouting at the top of our lungs. Yes, controls produced shortages in the past. No, it won't happen this time if we all get together and treat each other in love and think good thoughts and put a few corporation presidents in jail for six months.

Discounts from listed prices will start drying up prior to the imposition of controls. This is a sure sign to anyone who is planning for the future that it is time to start stocking up on raw materials, equipment, and spare parts. It is very important for businessmen to monitor their trade journals carefully. They should check every six weeks or so with suppliers about the availability of discounts. A good working relationship with a supplier is important. Tell him why you kept asking. Let him know that you are interested in how business is going. Don't go out of your way to tell him that as soon as he stops giving discounts, you are going to order like crazy from him. But let him know that you're interested. Any way you can get information on discounting practices in your industry, you should do it. They are a very good "early warning signal" in your field, which is the significant information anyway.

Inventories are important. When the managers start stocking up, the economy will be hailed as ready to take off again. The stock market will probably rise (don't take my word for the stock market, however, since I try to be rational about economics, and the market confuses me), and the newspapers will be filled with glowing tales about how well the President's prescription for the economy is working. But in a period of history that is inflation-conscious, *any strong rise in inventories should be regarded with suspicion.* It means that businessmen are trying to hedge against inflation by purchasing goods beforehand.

Interest rates, especially long-term rates, will start climbing again. The short-term rates are more volatile, however. A major move by businesses to increase inventories will drive up short-term rates. But they will try to get long-term loans if they can. They got whipsawed in the last two recessions. They don't want to get stuck with 90-day

notes if the economy should turn downward. But when short-term rates turn upward, be careful.[1] If long-term rates follow, then this is an indication that the professionals think the next boom will be an inflationary one. *The long-term rates are the inflation-hedging signal,* for long-term debt carries a large price inflation premium (lenders are trying to protect their future assets from the effects of depreciating money). Thus, when the short-term rates turn upward, watch long-term rates like bonds and mortgages. If they confirm the move of the short-term rates, begin to increase the proportion of your income devoted to the purchase of hard goods. When mortgage rates go above 15%, inflation will be on its way, if it hasn't already registered in the consumer price index.[2]

Raw materials shortages are an important sign of imminent controls. Newsprint is an important indicator, and so are the petrochemicals (plastics, etc.). If the firms you buy from start delaying the delivery of their cheaper lines of products, then there is trouble coming. Get in the markets and start buying. Usually, the major shortages will appear after controls are imposed, but some will appear before. Be alert to them.

Strikes. This is simply the method of trade unions to get ahead of the increase of prices. Businesses, I suspect, will capitulate. But a series of strikes will indicate that businessmen are too scared of price controls to grant the unions their demands. In other words, businessmen will figure out that in this cozy "partnership," they will be the ones first asked not to pass along all increases in costs. So they will balk at the demands made by unions. If the threat of strikes is followed by capitulation, then more unions are going to threaten their industries. *When the resistance is escalated, and strikes do hit the country, get ready for full-scale controls.* The President will want to maintain industrial peace, and controls will be viewed as one way to "put everyone on an even level." And if the strikers are public employees, the threat of controls is that much greater.

I have listed these signals in the order that I think is most significant, but there is no way to be certain that events will be so

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1. A very good source of information on interest rates and money-market funds is William Donoghue's *Moneyletter,* P. O. Box 411, Holliston, MA 01746 ($87/24 issues).

2. Mortgage rates hit 17% in late 1981 and early 1982. They have dropped to the 12% to 13% range as of October, 1982. I do not expect rates to remain lower than 13% beyond 1983, unless they are government-subsidized mortgages.

condescending as to follow my outline. But these are the kinds of indicators to watch closely. Remember: it is your business, your basket of consumer goods, and your decisions that are most important to you. Don't worry too much about the statistical aggregates; they don't necessarily reflect what is most important in your particular niche in the economy. At the same time, monitor each of these areas carefully. Don't make the mistake of thinking that events in one area (rising money supply, rising prices, strikes) are unrelated. They *are* related, and it is the coming together of several of these phenomena that should alert us to the possibility of action on the part of "the partners." If shortages hit your industry before the aggregates indicate universal shortages, you will have to take extra risks: to buy or not to buy, that is one of the questions. Is it temporary? But if the aggregates start pointing to a crisis—money is up, prices are up, long-term interest rates are up—then don't sit around calmly, even if your industry is still running smoothly. If one or two of the indicators move upward, take caution; if three or four do, take evasive action.

[Note: 1982 revision: I still think these signals are valid, as I did when I wrote this chapter over five years ago. Many of them came true after 1977, but the controls did not get imposed. President Carter either had a change of heart after his election, or else he did not believe the Congress would go along with him. I think the controls would have gone on in late 1980, had Paul Volcker's experiment in relatively stable money not begun in October of 1979. The Federal Reserve System pulled the economy back from the brink of mass inflation. It caused the recession of 1980-82. Now we will have an opportunity to see if the FED sticks with its "tight-money" policies. As of late 1982, M-1 was headed upward at a 20% per annum rate, and the Adjusted Monetary Base at close to 10%.]

Timing for Profits

Let us return to the original theme. What are profits? More important, over what period of time? Decisions that produce profits over a year's period of time may not prove to be profitable over a decade's span. This seems elementary, but it has to be repeated. We are living in one world, a world generally free of price controls (energy being the major exception). But we ought to be planning for a very different world. We will have to forfeit short-run profits for the sake of the long haul. *We must expand our time horizons.*

The trouble with this approach, psychologically, is that the short-term events will tend to make us confident. The country has experienced a major recession. Now (late 1982) it is pulling out of this recession. The *initial signs of danger*—meaning long-term danger from the imposition of price controls—will be interpreted by the Administration as *proof of the President's success*. Rising inventories, more employment, greater output, and similar signs of boom conditions will be interpreted as normal. The other signs, such as rising interest rates, rising prices, bottlenecks in production, and strikes, will be interpreted as unfortunate and even unrelated to the President's program. At the very least, they will be explained as side effects—*side effects that can be overcome by decisive action.* And the results of the recommended decisive action, namely, controls-produced shortages, will be explained as being the product of evil, greedy men rather than the product of the controls.

Any pragmatic tinkering with the economy by a President will produce side effects, meaning *unwanted* direct effects, but the innate pragmatism of the man, like the innate pragmatism of the voters who elected him and Nixon and Johnson and Kennedy—pragmatists all—will result in something like the following. First, he will like some of the effects. He will like the somewhat reduced unemployment figures, the greater output of goods, the signs of business confidence. (Rising inventories have historically been signs of business confidence, but in an economy threatened by controls, rising inventories will progressively be a sign of falling confidence in the future, although some businessmen and business analysts will always see rising demand as beneficial, even though produced by monetary inflation.) The incumbent President and his Administration will hail the wanted effects as the products of the "effective" policies of Federal spending, tax cuts, and monetary inflation.[3]

Second, the President will not like the other effects of his policies: rising prices, shortages, bottlenecks, etc. He will have a strong tendency to blame evil hearts for these results—a lack of commitment, greed, a failure to appreciate the needs of a decent society, and so forth.

Third, he and his advisors will design a program to punish evil

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3. In the earlier editions of this book, I attributed such ideas to Keynesian economics. George Gilder's "conservative" defense of "supply-side" economics calls for the same trio of policies: *Wealth and Poverty* (New York: Basic Books, 1981), ch. 18.

men. If evil men can be punished, and the other evil men see that this punishment is painful, then they will be restrained. If they are restrained, then the successful Keynesian policies will be able to operate properly.

Fourth, they will see price controls as a way to restrain "a minority of greedy businessmen and militant labor unions" and allow the majority of good men to enjoy the warm glow of Keynesian economics. Price controls will be imposed to control "the greedy minority." Price controls will be seen as a perfectly rational response to the evil actions of a minority.

Federal officials will call upon liberal think tanks like the Brookings Institution, and for the first time in recent history, the experts will recommend policies of "law and order." It may even sound conservative. But what they really will want is more government controls — more precisely, laws and orders. All of a sudden, punishment will get a good press. Crime doesn't pay, we will be told, under price controls. No more voluntary guidelines. No more voluntarism at all. No more Mr. Nice Guy. Get tough on evil. This will be the New Prohibition. Rev. Billy Sunday fought booze. The politicians will fight "price gougers." Justice on a white horse will be promised to all. Pragmatism will chase the evil-doers out of the land. Freedom will be curtailed on the legal, visible markets. Productivity will depart for "greener pastures" soon thereafter.

When it does, you had better be ready with a plan of action. In fact, your plan of action had better already have been in place for several years.

Conclusion

Timing is always difficult. The Federal Reserve can temporarily reverse its policy of monetary inflation, and then the imposition of controls can be delayed. On the other hand, if the President knows what will happen to his anti-recession policy of Federal deficits that are monetized by the FED, then he may impose controls in advance of widespread price hikes, as Nixon did in 1971. The best strategy is therefore a disciplined, steady program of personnel "mini-warehousing," month by month, paycheck by paycheck.

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A SHOPPING GUIDE FOR SURVIVAL

By now you have at least the general idea of what this country is facing and what a survival-oriented family will have to do to keep its capital intact. If you agree with my general analysis (nobody has to agree with each and every point to make me happy), then you will want to start taking action.

Where should a person begin? There are so many possibilities, so many different types of businesses, so many different families, and so many different needs, that no single plan will satisfy everyone. But I want to offer an acceptable outline. At least you will have some idea of where to begin.

I suggest that you take seriously the following recommendations. Mine are only the beginning. A similar approach is outlined in Part II of John Pugsley's excellent book, *The Alpha Strategy* (1980). If you are still doubtful about my book's thesis, read Pugsley's. It is available at many book stores, or from Common Sense Press, 711 West 17th St., G-6, Costa Mesa, CA 92627 ($14.95).

If you earn in the range of $10,000-$14,000 a year (as of 1982), it will be very difficult for you to do very much on your present income. You are already very hard-pressed financially. If you have children who can work, then I would suggest that you let them get jobs, contributing a portion of their earnings to a special family protection fund for long-term survival. Let them know what the money is for and how important it is that the fund be established. I would also recommend that you try to get a second part-time job. If you are short of time, give up television, or drastically reduce the time you spend watching it. If necessary, skip a vacation. Go to the library and start reading books that will help you develop a skill or trade. Go to night school, if necessary. But start using the one resource you may have, even if you don't have much money. That resource is time.

If you earn $15,000 or more a year, you have some breathing room. Not much, but some. Not for long, but for a while. If you can do any of the suggestions suitable for the $10,000-$14,000 family, do them. But you should be willing to set aside some money each month to make investments. One place to start is with the somewhat more conventional strategies outlined in Mark Skousen's paperback book, *High Finance on a Low Budget* (Bantam Books). If you have a skill, especially related to making repairs of machinery, develop that skill.

If you make over $20,000 a year, you should put a least 10% of your after-tax income into such investments as pre-1965 American silver coins, gold coins, handguns, rifles, tools of your profession, and a library. If necessary, take your kids out of college, or reduce the payments to them. (I never recommend taking them out of a Christian day school, however.) Let them earn more of their way. Time is getting scarce. This is an emergency.

Anyone who makes over $30,000 a year has the ability to hedge against the controls and even make the big money. It may necessitate moving into a less expensive home and using the after-tax profits for long-term hedging. It may require other stringent controls on the family budget. But there is no reason not to take the necessary steps. There is a lot of slack in the budget. If you must, sell off some status. Your investment in status may be too high anyway.

Survival-Hoarding-Saving

The steps you must begin to take should have the primary goal of long-run survival for your family. Let the dreams of big profits wait until these steps are begun. There is still time to begin, but once controls go on, there will be far less time. Your plans should be formulated now. What do you intend to do? How soon do you expect to reach your goal? How much do you estimate that it will cost to meet your goals, stage by stage? What are the resources available to you right now. Start taking inventory today. Count the costs. Estimate the benefits. This is the necessary preliminary step. If you don't start here, you really don't mean business.

Every family should try to make the following purchases (starting at top):

$500 face value worth of silver U.S. dimes
A six month's supply of dehydrated food

A home water filtration unit
Water storage facilities (5 gallon collapsible units)
Chemical toilet
Kerosene heater and lights
Survival stove or cooking device
Fire extinguishers (car and home)
At least one .45 Colt automatic pistol
A 30.06 or .308 rifle with at least a 4 × scope
A 12-gauge shotgun (pump action)
Ammunition for all guns (500 "rounds" [shots] for each weapon)
.22 long-rifle ammunition (10,000 rounds)
Air rifle (not B.B. gun)
Reloading equipment
A high quality ($200 +) first-aid kit, plus manual
A battery-operated short-wave radio
A citizens-band radio (40 channels)
Lubricants for all equipment (business & personal)
50 pounds of one-pound cans (or jars) of coffee (barter)
100 6-ounce tins of cigarette tobacco (barter), plus a cigarette rolling machine
20 pounds of inexpensive pipe tobacco (barter)
One case of expensive whiskey (barter)
One case of other expensive liquors (barter)
10 one ounce gold coins (South African Krugerrand)
20 quarter-ounce coins (one-quarter ounce Krugerrand)
30 Mexican 2-peso gold coins
5 U.S. $20 gold pieces (St. Gaudens)

Whenever possible, make all purchases in cash. This leaves fewer records. It is a good rule of thumb that the fewer records you leave of items to be stored for future use, the safer you are.

There is no doubt that few families in this country have anything like the recommended list of goods before a panic hits. Go at your own pace, but do start setting aside money for these purchases. You can buy silver coins in units of $100 face value. You can buy the cigarette tobacco, the liquor, and the gold coins in small parcels.

"What should I buy first?" This question must not be used to justify buying nothing. The answer depends on where you live, what your income level is, what savings you have, and how much you believe in this book. The silver coins are "survival money." They can be easily sold at a local coin store, or sold back to the firm that sold

them to you, or bartered, should a total panic hit the economy. They are very important. Food is important, too, but only with this provision: you really do intend to locate a safer place to live than a city of 100,000 or more people. It does no good to store food unless you store water, and it does less good to store food for the expected looters. If you say to yourself, "What good is my food when I live here?" you have just provided yourself with a first-rate reason for moving. Don't blame the vulnerability of the food; blame your geography. If you live in an area where the food is too risky to store, then you absolutely have to move. Not maybe; absolutely. Soon.

Where can you buy silver and gold coins? At a coin store or a pawn shop for cash. You can buy through the mail from companies listed in the appendix on "Services and Products." Buying and selling coins is easy, for the present. And if you say to yourself, "Some day it may be difficult to sell my coins," you have just given yourself the best reason to buy them now. The only thing that would make it difficult to sell coins is the imposition of full-scale price controls and even tyranny. That is precisely the time when you have to have the coins, for barter purposes. If you refuse to buy any coins, then you haven't understood (or believed) this book.

It is true that coins "earn no interest or dividends." It is also true that the value of silver American coins increased from about $1,100 per $1,000 face value in 1971 to $25,000 in early 1980. Then they fell back to about $5,000 in mid-1982. They they started back up again in July, 1982. My point: they go up in inflationary times more than interest compounds. Silver is an inflation (boom) hedge; interest-paying investments are recession hedges. Gold coins did as well as silver in the 1971-80 inflationary period until the final panic move, when silver bags went to $25,000 very briefly. Some rare coins did far better.[1] The chatter about "no interest" is not that impressive when you consider the capital gains involved. And never forget: capital gains profits are taxed at a lower rate than interest or dividend income.

Another very interesting proposition is the availability of loans for

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1. Let me stress that no single investment performs well in every phase of the business cycle. Three-bedroom, two-bath homes outside California, but in the Sunbelt, probably did best, 1971-82. But for "buy and hold" investments, you have to ask yourself: When do I plan to sell, in a panic inflation or a panic recession? Buy inflation hedges to achieve the first goal, and 90-day Treasury bills or a T-bill money-market fund to achieve the second.

gold and silver coins or bullion offered by Deak National Bank. They call this the NDR (Negotiable Depository Receipt) program. It is available only to precious metals certificates clients. The bank will offer up to 50% of the market value of the coins or bullion ($15,000 minimum value of the metal, minimum loan at $7,500) at the prime rate plus 3%, interest payable monthly. You get the interest deduction on the loan, which helps lower your income taxes. There really is a bag or bar of precious metal, stored at the Bank of Delaware in Wilmington. Deak National Bank makes the loan on the basis of this warehouse receipt. Pay off the loan at any time, and you can take delivery of the metal. Most bankers refuse to make such loans. The risk: if the market price of the metal falls, the loan-to-metal value ratio hits 70%, the bank will sell your metal. In short, you can get a "margin call," as in the case of any other leveraged market investment (except real estate). For full information, contact Mrs. Sims at:

Deak National Bank
Main Street
Fleischmanns, New York 12430
(914) 254-5252

For a higher-risk proposition, but one which would seem to be legitimate, given the inflationary nature of the crises which is facing us, the man with $15,000 to invest in a home, whether his actual residence or an income-producing unit, might want to buy 5 bags of coins using $7,500 of his money and a $7,500 loan. He could then take the other $7,500 and put the down payment into the house. He would wait for the appreciation of the coins, selling off the coins in two or three years, or even longer, paying off the loan against the coins and the loan (or a big chunk of it) outstanding on the house. This is a rational use of debt, since the likelihood of the coins or the house falling in dollar-denominated value is rather low. The government subsidizes this transaction by offering the interest rate deduction on the annual income tax report. You use an appreciating asset to gain access to depreciating paper money; the money is then used to pay off a loan. Or, if the dollar really collapses, the man can pay off both loans, take delivery of the coins and possession of the house. Dollars would not buy much under such a scenario, but they are useful for paying off dollar-denominated debt. I call this approach

compensated leverage. The debt is backed up by appreciating "hard" assets.

I am not wildly enthusiastic about using leverage (borrowed money). The collapse of silver from $50 per ounce to $4.89 per ounce, 1980-82, tells us what we always suspected: there are no risk-free investments and therefore no "free lunches" in the investment field. *The best two-way hedge is to pay cash, own everything outright, and thumb your nose at both deflation and inflation.*

People seldom consider the possibility of a breakdown in the municipal water system. If you could not get water out of the tap for a week, you would be in desperate shape. Earthquakes, terrorist attack, or a war could threaten the urban water delivery systems. I strongly recommend the purchase of *5-gallon collapsible water jugs,* produced by the Reliance Company. Most survival products companies sell them. As of late 1982, you can get a dozen jugs for $60, two dozen for $115. A chemical toilet is also a good idea. Price: $28. You can buy these individually, or buy a $165 ($195 retail) Utility Pack: 24 jugs, chemical toilet, Port-A-Sink, and a solar-heated shower spray. Order from:

Legacy
P. O. Box 7337
Tyler, TX 75711

An *emergency portable water purifier* is not very expensive. A decent one is the portable Water Washer unit, which sells for $39.95, plus shipping. (Replacement filters are $15.95, plus shipping.) Always ask to see if a discount sale is available. It can be ordered with Master Charge or Visa from:

Survival Center
P. O. Box 707, Dept. 65
Ravenna, OH 44266
(800) 321-2900

SI Outdoor Food & Equipment
P. O. Box 1940
Redondo Beach, CA 90278

There are other companies that offer various survival and self-sufficiency products. There is no reason not to write to all of them for catalogues and other information. Two additional firms are:

Core Resource
P. O. Box 4526
Mountain View, CA 94040
(415) 961-3763

Josef's Storhaus
800 N. Devine, Suite 101
Vancouver, WA 98661
(206) 254-6292

Josef's Storhaus offers a smaller selection, but it gives the best prices. For a $10 annual fee, the firm will make available survival products for 10% over dealer cost, plus shipping. This is unheard of in the industry. They offer items that are not considered survival products, but that are educational or very useful. They offer Panasonic short wave radios at very competitive prices. They also seem to have the best prices on diesel-powered generators. Here you want at least 5 KW, preferably 7.5 KW, with an 1800 RPM engine. The firm also sells a high quality emergency medical kit.

Another item to consider is a solar water still. This will enable you to get pure water from ocean water, polluted water, or just plain tap water. These stills can produce from two quarts a day to 5 gallons, without moving parts or electrical power. They cost from $300 to $800, depending on capacity and installation. You can buy them with roof-top assemblies that will pump water into your kitchen. These do take electrical power, however. They are good investments, whether or not a crisis hits. Some health food advocates say that distilled water is best for you. I know it tastes better than most tap water. The source of these solar stills is

McCracken Solar Co.
P. O. Box 1008
Alturas, CA 96101

As for *air rifles* and *air pistols,* I cannot recommend them highly enough. Here is the way to learn to shoot safely, inexpensively, and accurately. When I say air rifle, I don't mean a Daisy BB gun. I mean a precision sporting weapon. SI Outdoor Food & Equipment sells air rifles, but three other companies offer specialized air rifle catalogues, and you would be wise to order them before you buy. Compare prices and service. Service is important.

Beeman's
47 Paul Drive
San Rafael, CA 94906
$1.00

Air Rifle Headquarters
P. O. Box 327
Grantsville, WV 26147
Free

Barnett International
125 Runnels Street
Port Huron, MI 48060
$2.00

The RWS 27 air rifle is sold by SI Outdoor Food & Equipment for about $145. It will get you started, then hooked. The ammunition is incredibly cheap, and the weapon is very accurate up to 35 yards. The finer weapons sell for up to $600. These weapons do not have to be registered . . . yet. The Feinwerkbau 124S (retails at $275), coupled with a good Beeman 2-5X scope ($60), is a terrific weapon. There is a deluxe model that costs even more. But these are superb weapons, not toys. They are excellent for competition, but also for hunting small game. They are very quiet and very accurate. As for air pistols, the Webley Tempest (Beeman's) is a good one. You can pay up to $300 for the better pistols, but these are sporting items, not survival guns. (Note: prices can change—upward—for all these weapons. Use these prices only as a general guide.)

A good *rifle* for the money is the bolt action Remington BDL-700 (30-06). You need a *shotgun*. Recommended: Remington 870, 3″ magnum. The Remington 1100 is a semi-automatic: pull the trigger and it shoots. They are legal (full automatic is illegal). Get the shortest barrel legal, 20 inches. It is a real crowd subduer. As for *handguns* I think the Colt .45 semi-automatic pistol is by far the most effective defensive weapon, with the .357 magnum revolver (Colt, Dan Wessen, or Smith & Wessen) coming in second. The .357 will also fire .38 caliber ammunition. The .45 has great stopping power. For more on guns, see Mel Tappan's book, *Survival Guns,* available from Janus Press: P. O. Box 598, Rogue River, OR 97537 ($8.95). (A word of warning: keep your reloading equipment out of sight. The presence of such equipment alerts neighbors and local authorities that, in all likelihood, more than one weapon is owned by the sportsman. Some people buy cheap weapons and plan to turn them in, if forced to, while keeping the good ones hidden. If that's your plan, keep the reloading equipment equally hidden.)

Serious survivalists should subscribe to *Shotgun News.* Address: P. O. Box 669, Hastings, NB 68901. Price: $15 for 36 issues (240 pages per issue). It is all advertising, and it is the place to begin.

The barter items are the traditionally high-demand products, which some religious groups regard as vices, but are widely indulged in. Indulgence, rather than vice, seems to be the better classification. Tobacco, good liquor (which can't be brewed up on a local still over-

night), coffee: people will trade to get these items. They make very good presents for people like local sheriffs, especially good whiskey like Jack Daniels Black Label or Wild Turkey. You will need the cooperation of men like the local police chief. Make Christmas nice for them. Or their birthdays. Or Groundhog Day. Almost any day will do.

Personal Items

Such things as toilet paper, toothbrushes, tooth flosser, hair brushes, sanitary napkins, aspirin, bandages, antiseptics, and similar items should be stored up regularly. Watch for sales in the supermarkets and buy in bulk. Or join a co-op. The problems of deterioration (aspirin) can in part be overcome by freezing; box them up and stick them in the rear (or bottom) of a freezer. Photographic film can be frozen, too (allow 24 hours for it to defrost before using). I strongly recommend the purchase of a 35 millimeter camera ($100-$200 range) and bulk film (black and white), plus developing chemicals (dry packed), paper, and an enlarger. Memories are going to be very precious in a time of real trouble. This is why photography could become a very profitable second job, especially after a major crisis.

The problems of storage space are not easily overcome. How do you stock up on enough toilet paper for a family of five for a period of six years, ten years, or more? It is a troubling thought. The use of styrofoam containers, wrapped with chicken wire, is one way to keep out mice and rats, at least for a while. The picnic box kind of containers are ideal, the kind you keep the beer on ice in when you go to the Big Game. For paper products, the attic is a better place to store them than in the basement, since moisture is a real problem. For food or other perishables, the basement is better because of the cooler temperatures. People who live in apartments in a city shouldn't. Nevertheless, if they have to stay where they are, it might be wise to rent some square feet in one of these miniwarehouses that are springing up around the cities. (They are a good place to go to auctions, too, so don't forget to meet your payment schedule. They will sell your stuff.) I suggest that you pay cash in advance for several months, which leaves no record in your checking account. Some very cautious people may prefer to give an alias and mail drop

address, too.[2] Privacy counts. For the present, there is no law that says that hoarding is illegal. When such a law is passed, it would be wise to clean out your mini-warehouse and transfer the goods to a less public location. If there is no record that you ever rented warehouse space, so much the better.

The *food storage program* wouldn't do much good if riots, fires, or war were to break out. The food on hand would be stolen, or if not stolen, would be useless if the city's water or power were cut off. Food storage in a city is recommended only because people can pick up and leave a city, if necessary (maybe), and they can eat stored food if food supplies get tight for a couple of weeks. They add more protein to a diet. There will eventually be food rationing inside the major cities. It pays to have some food on reserve. Also, in the country, a drought or fire or flood could hit the crops. A reserve is wise. Peanut butter really is an ideal food as far as storage, protein, cost, and acceptability with children are concerned. Large cans of it can be ordered, but if you can get the non-hydrogenated (oil at the top) variety, pay double. Problem: oil makes food turn rancid after a year or so. One answer: powdered peanut butter, along with soy oil or other oil that is stored in air-tight bottles. The oil will keep for many years if it is kept properly sealed. A food storage program must include oils. Cans of honey can serve as the family's main sweetener. Buy a small can, and if you like it, order it in 5-pound or even larger cans.

Light Bulbs: Convert incandescent bulbs (which burn out continually, run expensively, and are likely to get scarce) to fluorescent lighting. Look into the KillerWatt conversion units that are sold by Montgomery Ward and Penneys. General Electric has also introduced an incandescent-to-fluorescent conversion kit, the Circlite. They require far less electricity per unit of light.

To triple or even quadruple the life of regular light bulbs (but not the three-way bulbs), buy a box of *Bulb-Misers.* These little units use a NASA-developed technology called thermistor technology. Insert

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2. A mail drop is a most convenient device. This is a mail forwarding service. You rent the services of someone who will collect your mail and forward it to you. You can use any name you want to for letters to be sent to your drop. It establishes one more layer of privacy between you and those writing to you, or those who are trying to trace you. For a list of mail drops in the U.S. and several foreign countries, read *Directory of Mail Drops in the United States and Canada,* compiled by Michael Hoy.

one of these in the base of the socket. You flip the light switch, and the bulb slowly brightens, from yellow to full white, in about 30 seconds. The thermistor keeps the filament from getting hit with a surge of power—a surge that wears out the bulbs prematurely. As the bulb warms up, more power is allowed to flow through the thermistor, and the bulb brightens to full intensity. These are not resistors, which use a different technology, and which do not permit full power to flow through the bulb after it warms up. A box of a dozen Bulb-Misers costs \$36 (\$24 for *Remnant Review* subscribers). Order from

Bulb-Miser
P. O. Box 2707
Harbor, OR 97415

Aladdin lamps: These are high quality kerosene lamps that really brighten a room. They are not noisy or smelly. The company also sells kerosene heaters.

Salt: You have to have it. Buy it in inexpensive boxes, and buy lots of it. Buy 30 or 40 boxes. Keep them sealed, thereby reducing the threat of moisture. If you're in the country, I'd buy a barrel of it from the local grocer. He can special order it. If there is trouble with refrigeration, salt will be a crucial preservative.

Sugar: An excellent barter item. Give it up yourself, and buy a barrel of it. Keep it in the attic, away from moisture. It's a preservative, too.

Nails: Buy a barrel of them.

Barrels: Buy a barrel of them.

Tools: Any time Sears has one of its special sales on its Craftsman tools, buy all you can. Even if you can't hammer a nail straight, you can always swap the use of your tools (in your shop or garage only, of course) for services from a skilled, but tool-less, worker. Tools are a great investment. The prices only go up.

A Food Storage Program

This is very important. People generally avoid taking this step until they are fully convinced that a major crisis is possible. When you buy your first cans of dehydrated food, you are acknowledging to yourself that the present food-delivery chain could be broken. This means that you cannot fully trust "conventional wisdom" any longer.

Taste various brands in advance. Some companies sell inexpensive sample packs. Simpler Life Foods are the Arrowhead Mills brand. Most health food stores carry Arrowhead Mills organically grown foods (not dehydrated, however).

You can assemble a $350 food storage program, using honey, milk, wheat, salt, and some basics, that will give you 2,300 calories a day for a year. It is not a well-balanced diet, but it will keep you alive. Bill Pier describes the program in his *SI Catalogue*.

Each food storage program seller claims that his program is the best, cheapest, and gives you sufficient proteins and calories for a year. Yet prices vary from $800 to $1900 for the programs. You have to look at what you get and then compare the various programs with your eating habits and pocketbook.

Storing food and water represent a major psychological break in a person's life, far more radical than buying a few gold coins—or even a lot of gold coins. *To buy a food storage program means that you have admitted to yourself that there could be an interruption of urban society's life-support systems—a total breakdown.* I realize that few people will make this psychological break. I have made it. I have tried in this book to demonstrate how price controls and rationing could create major problems in the food-delivery system in the U.S. If you take my thesis seriously, you will follow through on a food storage program of some kind.

SI Outdoor Food & Equipment sells a one-year program, the Maxi Unit, for $1850 (as of late 1982): 2,400 calories a day, balanced meals, meat every other day, fats and oils. At the other end of the price spectrum is the Survival Center's program, "Susie's Basic Unit": 13 nitrogen-packed grains (mostly organic, suitable for planting), 2,200 calories and 105 grams of protein a day, meats and fruits: $840.

You will need a grain grinder. Several good ones are available: the Excaliber, the Magic Mill II, and the Marathon. All three are electric. There is a bicycle-powered unit available from the Survival Center for $120, the Hi-Life mill and attachment.

Now is the time to get started. It takes determination. It takes money. It takes planning. It takes the courage to examine what the future seems to have in store for us, and then the courage to start dealing with that future. But the family that follows these sugges-

tions will be far less troubled when the trouble hits.

You may want to buy food storage directly, or get involved in a small business related to food sales. It is not an easy business. In periods when food is cheap and easily available, nobody is interested in buying. When a food crisis hits, everyone will want to buy, and there will be no product to sell. Overnight, the food storage sellers could be cleaned out. This is why you have to prepare in advance. The problem is, it is very difficult to convince buyers of the grim reality of this scenario. Selling food storage is hard work. One advantage is that firms offer discounts on multiple orders to distributors. Companies that can help you set up a small business as a food distributor are

Martins Distributing Company
P. O. Box 725
Carlsbad, CA 92008
(800) 824-7861 (toll-free, USA)

Simpler Life Foods
P. O. 2059
Hereford, TX 79045
(806) 364-0730

Simpler Life used to be known more for their organic grains and beans. The company has now added more fruits and vegetables. A 30-month "Super Unit" costs $2,565 (68 different foods); a 24-month, one-person "Family Unit" sells for $1,354 (35 different foods; probably the "best buy"); an 18-month "Savers Unit" for $947; a 12-month "Basic Unit" for $622; and a 6-month "Refill Unit" for $309 (9 different foods); a 3-month "Variety Unit" is $381. The cheaper units have reduced variety, of course. They also sell specialty units: vegetable unit, fruit unit, meats and dairy unit, condiments and sweeteners unit. They describe their philosophy in a series of paperback books: *The Simpler Life Menu Planner, The Deaf Smith Country Cookbook, Occupy: An End-Time Strategy for the Believers, The Coming Food Crisis,* and *The Simpler Life Cookbook* ($10 per set of five). The company is run by Pentecostal Christians. Most of the other firms seem to be owned by Latter-Day Saints (Mormons).

And remember: you need water to use dehydrated food. Starting a food storage program without providing for a source of water is ridiculous. Even if you have to drink water from a water heater, you have to have water. Water jugs from Legacy are a better idea.

Study Materials

At this point, some readers may be thinking to themselves, "This

stuff is crazy. Stored food? Air rifles? Shotguns? This is America. It can't happen here!"

All right, maybe it won't happen here. Maybe we will get stable prices, economic growth, low unemployment, reduced taxes, and an unbeatable national defense system. This is what the politicians promise us every four years. Problem: they have been unable to deliver so far. The numbers keep getting worse: high unemployment and bankruptcies during the "anti-inflation" periods (when price inflation drops to a "mere" 6%), and high inflation during the "anti-recession" periods.

If you think all this is crazy, you should continue to investigate these subjects. You can do more reading. I think you should. I have introduced you to one side of the "crisis syndrome": price controls and rationing. You should become more familiar with the "hard-core" survivalist literature.

Easily available and very useful are the trio: *The Last Whole Earth Catalog, The Whole Earth Epilog,* and *The Next Whole Earth Catalog.* These offer "access to tools," the covers say. Coupled with the *Mother Earth News* (105 Stoney Mt. Rd., Hendersonville, NC 28739), they offer a daydream world of alternative life styles. Some of these daydreams could, if put into effect prior to a major crisis, keep life from becoming a nightmare.

A good general survey is C. G. Cobb's *Bad Times Primer,* a 334-page paperback that offers information on shelter, food, energy, transportation, communication, tools, trade goods, and priorities. For $14.95, it is a bargain. It will save you many hours. It may save you your life, if you act in terms of what you learn.

The late Mel Tappan wrote *Tappan on Survival,* which is as good an introduction as any. His wife still publishes the *PS Letter,* a very good source of information. The book sells for $7.95 (Janus Books, P. O. Box 578, Rogue River, OR 97537).

One book gives you the names and addresses of hundreds of suppliers, *The Survival Resource Book,* edited by Martha Henderson ($8.95). It covers government sources, land, gardening, orchards, tillers, livestock, outdoor equipment, tools, weapons, first aid, and on and on. Well worth the money. Order from SI.

On nuclear war, there is Cresson Kearny's *Nuclear War Survival Skills,* which was originally a publication of the U.S. government

agency, and very difficult to locate. It is a practical book written by a specialist at the famous Oak Ridge National Laboratory, located in Tennessee. It sells for $9.95 from NWS Research Bureau, P. O. Box 1144, Coos Bay, OR 97420.

Also excellent is *Life After Doomsday* by Dr. Bruce Clayton, a specialist in ecology ($8.95). Clayton's little book, *Urban Alert!: Emergency Survival for City Dwellers* is extremely useful ($12.95). He has written an annotated bibliography, *Survival Books of 1981,* which I recommend as a good introduction to the whole field ($14.95). Most survival companies carry his books, or order from Clayton Survival Services, P. O. Box 1411, Mariposa, CA 95338.

Another bibliography that introduces you to free market books, hard-money newsletters, survival books, and so forth, is Anton Andereggan's *Blueprint for Crisis Preparedness.* It also includes rudimentary chapters on financial planning. As a short-cut to materials, it is worth $10. (Pacific Gallery Publishers, P. O. Box 19494, Portland, OR 97219.)

A "hard-core" survival magazine is *Survive,* P. O. Box 311, Martinsville, NJ 08836 ($22/12 issues).

Capital Gains

I distinguish survival investing from conventional investing for the purpose of making increases in one's risk-oriented capital. Of course, all investing must bear risk, but some investments are riskier than others. They should offer higher rates of return as a result. I offer the following suggestions to those with extra capital. This means those who have taken the steps listed under "survival-hoarding-saving." Since it would cost many thousands of dollars to complete the earlier program, many of you will not have the resources left to pursue these strategies. However, if you have taken the recommended steps, you are far more protected than most urban-dwelling Americans. The "personal items" alone will set you apart.

Real estate: The most useful approach for the person with time, but not as much money, is to go with the approach made famous by William Nickerson and Al Lowry, but also developed by Robert Allen and A. D. Kessler, all of whom have written best-sellers on the subject. This involves locating "problem" properties—the owner

may have the problem, or maybe the property does, or both—buying them with little or no money down, correcting the problem, and trading (not selling) the now "cured" property for additional properties. By trading, you defer capital gains taxes. This makes it possible to build up your resources far more rapidly. You use debt in this system, and unfortunately the proponents of this approach never warn you against the possibility of collapse. They also do not mention the threat of national rent controls. Therefore, you have to go very carefully. But the technique is sound: locate a "problem" 3-bedroom, 2-bath house in a decent neighborhood, especially if it has an assumable, fixed-interest rate loan on it (FHA, VA, etc.), correct the problem, rent out the unit, and do it again. It is the best way to build assets rapidly. It takes a lot of work and courage. I would recommend only small-town investing in single-family dwellings. No apartment houses, please; the threat of rent controls is too great. If you must invest in a city, make sure there is public transportation nearby: gasoline rationing threatens suburban investments in some cities (such as Los Angeles). By far the best inexpensive monthly magazine on real estate is *Creative Real Estate,* P. O. Box 2446, Leucadia, CA 92024 ($40/yr). It teaches you how to buy real estate at wholesale prices. When you are talking about investing thousands of dollars, this is the way to buy.

Precious gems: This is already a big field. Up until the collapse of 1980-82, everyone was touting investment-grade diamonds. I was even mildly enthusiastic, although I favored (and still favor) rare coins. But as I wrote in earlier editions of this book, the best way to buy diamonds is at a pawn shop. If you can get the owner to sign a 48-hour right of return, you can buy the stone or ring, take it to an appraiser, pay $5 for an appraisal, and keep the stone if he says that it's worth more than you paid for it. The closer you are to a military base, the better the selection. Too many men receive "Dear John" letters. Used engagement rings are a glut on the market, and few men are willing to keep them for their investment value. They think that lost sentiment somehow destroys their world market value. So many of them think this way that the market for used engagement rings really is depressed close to military bases. Be an entrepreneur. Buy the other guy's mistake and hold for long-term appreciation.

In earlier editions, I wrote: "The problem with diamonds is sim-

ple: you are at the mercy of the appraiser, unless you have the time (and stomach) to bargain. There are other investments, most notably rare coin investments, that provide comparable appreciation but greater liquidity. But for hiding huge amounts of capital in easily hidden, easily transported, always valuable forms, nothing beats a high quality, investment grade diamond (one carat or larger). As a 'buy and forget' type of investment, diamonds are excellent. Again, you must have a reliable dealer, and you must allow up to two months waiting time for your dealer to get the best price, at least in some instances. Never sell under pressure, unless it's really life and death." Investment-grade gems are for the very well-heeled passive investor.

Jewelry-grade stones do well in inflationary times, and they do reasonably well in deflationary times—better than investment-grade stones, anyway. You are buying them at 25% of retail, allowing you a 100% mark-up. They are relatively liquid, given your low purchase price, unlike real estate, and they are durable, transportable, and scarce. They have most of the elements of money. They can be hidden. They can be moved quietly. It is difficult for tax collectors to tax them (again, unlike real estate). Once you have 20% of your liquid assets in "survival" gold and silver coins, meaning the so-called bullion coins, you can consider gems.

What about colored gemstones? Again, these are passive investments for the long-term investor who does not need liquidity. The aquamarines and topazes are "poor men's diamonds," and the percentage increase of their price during the 1970s has been as spectacular as the rise in diamonds.

Rare coins: For liquidity, safety, and capital appreciation, nothing beats rare coins during an inflation. They are not as subject to fluctuations in the gold and silver bullion markets, unlike the bullion gold coins and "junk" silver coins (pre-1965 U.S. coins). They rise far more rapidly in inflationary times, at least until the final weeks of panic collapse, when the bullion coins may perform better, and food probably does best of all. The trouble with rare coins is simple: it is very difficult to get good advice about when to buy and sell. My newsletter on rare coins can help you (see the Bibliography). I would advise starting with type sets of U.S. gold coins.

I think that at least 15% of a person's liquid assets (not counting

his home) should be in rare coins. For a wealthy, long-term, passive investor, I think that 20% would be preferable. For any portfolio above $100,000, at least 20% should be in rare coins, 10% in gemstones (preferably jewelry-grade stones, for more active traders), 30% in bullion gold and silver coins, with the rest in mining shares, growth stocks in a "switch fund," and/or three-month Treasury bills. (I am not including real estate holdings, a separate category.) This kind of portfolio will withstand everything except outright confiscation and dictatorship, and the coins and gems will even help to mitigate the effects of tyranny, since they are easily concealed forms of wealth.

"Penny" gold mining shares: If we ever see the price of gold above $1,000 per ounce, we will be viewing true "gold fever." When this strikes the investing public, there will be a rush to buy gold mining shares. The South African shares have a bad press. The familiar North American shares are few and far between. They will be overpriced. That leaves only the exploratory, high-risk, low-production, "penny" shares, which sell from a few cents per share to several dollars. If gold fever hits, these could pay off at 10 to one or 50 to one. They are a good crap-shoot for about $3,000 or up to 5% of your portfolio. Warning: this is very speculative, or can be. But the goal is to buy thousands of shares and hold them until gold panic hits. Then sell them at high prices to the lemmings coming in who want to gamble, really gamble.

There are many risks. The big ones are these. First, gold prices get controlled by the government. Miners cannot sell the gold legally at a true market price. Second, gold mining equipment gets scarce because of price controls on industry in general. Third, a major World War breaks out, and conventional investments are frozen. Fourth, your broker is a crook and loads you up with shares in a lot of "goat pasture." The goal is to buy several mines, hope for the best, and unload them in the midst of "gold fever." Then use the paper money to pay off all your debts, especially real estate debt. Maybe "penny" gold shares will get you off the debt pyramid.

One broker who specializes in the exploratory mining shares of North America, both silver and gold, is Jerry Pogue. The minimum figure to get into this market is $5,000. *Remnant Review* subscribers can get in for $3,000. He can be contacted at

National Securities Corp.
500 Union St.
Seattle, WA 98101
(800) 426-1608

There is no need to rush in all at once. There could be several "gold dumps" by the U.S. Treasury before true gold panic hits. Never buy in a panic market, if the market is skyrocketing upward. That's the time to be steadily, quietly, and profitably selling. That's the time when the brokers will be calling you in an attempt to locate shares to sell to the late-comers who have just read about penny shares in the *Wall Street Journal*. They probably won't publish anything favorable in the *Journal* until it's time to start unloading. When the "unconventional gamble" starts looking somewhat conventional and "a reasonable high-risk investment" in the bulletins of the large brokerage houses, it's time to start unloading. Don't call them; let them call you.

The thing I like about these shares is that the upside potential in a panic gold market is 5 to one, 10 to one, or more, yet there is no downside risk beyond the money you put into the original purchase. Unlike the highly leveraged commodities markets, if gold falls, they can't come and confiscate all you own. You get *maximum leverage* and *minimum downside risk*. For a detailed study of these stocks, see the book by Norman Lamb, *Small Fortunes in Penny Gold Stocks,* published by the Penny Mining Prospector, 11141 Georgia Ave., Silver Spring, MD 20902 ($15.95).

"Pure Equity" Trust: Some people were being approached in the late 1970s by salesmen who were not lawyers who peddled an incredibly overpriced gimmick called a "pure equity" trust or "family equity" trust, also called "Constitutional" trust. It involves giving your assets to the trust, and you and a second party, normally your wife, become trustees of the trust. Then you contract with the trust to provide your services to it as an independent contractor. The salesmen tell you that you can "split the income" by filtering it through the trust. The beneficiaries of the trust (wife, children) get their share of the income, and of course most of them are in lower tax brackets. Salesmen fail to mention one slight complication: the courts have denied the legality of income splitting through a trust (in 1978), and the Supreme Court refused to reverse the decision. Thus, those who set up these trusts are in store for some very unpleasant audits and

back tax assessments, plus interest. I would suggest that you ignore this option.

Recently, salesmen were peddling an "off shore" (foreign-based) trust package very similar to the now-defunct "pure equity" trust. It is easy to predict what the results will be.[3] This is not to say that foreign trusts are not a possibility, but they should be set up by men who are skilled in the field. No "miracle paper" will deliver Americans from the clutches of the tax collector.

These trusts are not the same as the simple inter-vivos trust like those found in Norman F. Dacey's book, *How to Avoid Probate* (New York: Crown Publishers). For people with estates under $100,000, the Dacey book is probably very useful, despite the opposition of the legal profession. A good trust lawyer is expensive. Better to rely on Dacey's book than not to do anything about your estate before your death. Dacey is better than nothing, and nothing is approximately what most American men do about their estates prior to death. (Nothing is what all of them do after their deaths.)

For those who need advice concerning the possibility of establishing a foreign trust or other off-shore entity—a form of business operations that has, as a possible secondary benefit, some important tax consequences, I recommend A. Hardcastle, whose law offices are in Dallas. Phone: (214) 748-9901.

Survival home: Probably the most important decision you can make concerning the possible crises that are coming is to move to a safer geographical location. A rural or semi-rural area is ideal. You may choose to live in a small town (under 25,000) and garden in your back yard. You may live a few miles outside of town.

Life Insurance

"Can I buy this stuff any cheaper?" Only 20% of life insurance buyers bother to compare prices for policies. This was the conclusion of a survey taken by the American Life Insurance Council on more than four thousand recent insurance buyers. Furthermore, most people who did do comparison shopping asked . . . you guessed it: the same agent who sold them their existing policy. Or maybe they asked a friend. (So who did the friend ask?)

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3. The last I heard, one promoter of these trusts was a fugitive from justice in a foreign nation. My warning in earlier editions of this book seems to have been accurate.

Knowing this, most agents actively foster the idea that all policies are the same. Yet nothing could be further from the truth. A forty-year-old male, for example, can purchase a $100,000 life insurance policy for as little as $200-$300 for the first year's premium, or as much as $2,000-$3,000.

That's right: *a* ***ten-to-one*** *spread.* How would you like to buy a new car this way? With the new car, you know the difference between a Rolls Royce and a Ford. At least you can take a test drive. Nobody wants to take a test death.

The Buyer's Rules of the Game

Here's the primary rule for buying anything:

> **Never assume that your barber sells the cheapest haircut in town, unless you *really* want to get clipped.**

The same rule applies to life insurance. Never assume that your insurance salesman sold you the best policy for you. Assume that he sold you the best policy for *him.*

Your problem in the past has been that you couldn't locate anyone who was in the "barber price comparison" business. That was my problem, too. You couldn't find where to buy at the best price. Well, it's not a problem any longer. Not for me, anyway. *I* ***know*** *where.*

When I first started looking for inexpensive life insurance (since, quite frankly, I'm cheap), I wanted to be able to get the best value for my money, but I found out that there was no way for me to compare policies and prices. It was taking me too long to do the search. *It was costing me too much in lost time to make the search.* My time is just too expensive to waste. So is yours. (You think life insurance salesmen aren't aware of this difficulty?)

So I got my research staff to start looking. Here's what they discovered:

1. Premiums vary significantly within every class of produce. It's not just that the life insurance equivalent of a Rolls Royce costs more than a Ford. It's that prices even within the Ford category can vary over 200%. In short, if you don't compare prices among various companies, the odds are very high that you'll pay more (probably much more) than you have to.

2. There are more than 2,000 life insurance companies in America. Most of us don't have the time to compare that many

policies and search out the best value, not to mention the hassle of dealing with a dozen or more insurance salesmen.

Are you getting the drift of my argument? The problem has been, *until now,* how to compare the prices.

I came up with the solution. Actually, my company's in-house computer whiz came up with it. He wrote a computer program for me that can sort through hundreds of companies and dozens of policies, and come up with the five cheapest policies, given the buyer's specifications.

Question: Do you think I got him to do this free of charge?

I have decided to get my money back on this project . . . and then some. I've set up a computerized cost-comparison shopping company. It's called **InsuranceQuote**. **InsuranceQuote** uses high-speed computers to provide a super-fast search of the life insurance industry to find you the best rate for the type of coverage that you need. Not just one company . . . at least five. And best of all, your **IQAnalysis** is free.

(Suuuure it is. O.K., I might make just a teeny weeny profit somewhere in the deal. I figure that if I can save you, say, $5,000 *after taxes*—and maybe more—over the next decade, you'll buy the policy from me as a favor. But to keep this deal legitimate—*a true "I'm not a barber" deal*—I really will send you the information free of charge, and you can buy it from anyone you like. Even the guy who stuck you with that high-commission turkey you now own.)

Why Price Is *the* Consideration

Let's start with a basic understanding of the insurance industry. Life insurance is basically the same with all major companies. Your first priority is *safety.* You want the assurance that the company will pay off if you die. With top-rated companies, you have virtually no fear that your heirs will collect. The laws in most states require the insurance companies to "re-insure" with each other. In this way, if a company goes under, its policies are still in force. The fact is, few insurance companies ever go broke. (With the kind of policies most buyers buy, I can understand why they don't.) Thus, as long as you are dealing with large, top-rated firms, ***price** is the only consideration for the type of coverge you desire.*

Most buyers don't believe this. That's why rates can vary so widely between companies: ignorance of the part of buyers. Some

companies are getting rich because of buyers' ignorance. (I would say that almost all of them are. For proof, keep reading.)

When evaluating life insurance companies, **InsuranceQuote** employs the services of the nation's oldest and most respected insurance evaluator, A. M. Best, established in 1889. In its annual insurance encyclopedia, *Best's Insurance Reports,* Best ranks most U.S. insurance companies in terms of their financial strength, profitability, and overall management. We recommend only the strongest and most profitable companies which have received Best's highest rating—A+ or A (Excellent). You should consider purchasing insurance only from companies which have earned this high rating.

There are several hundred large insurance companies which have attained the A+ or A (Excellent), and most will offer a variety of insurance products which will fit your needs. *Prices,* for the coverage you desire will vary significantly. And since price is your primary consideration, not which company or salesman you buy it from, compare the rates of as many companies as possible.

No, now that I think of it: have my computer compare the rates. All it takes is a toll-free call to **1-800-972-1104** (Texas: 214-490-7720, collect). The money you save can certainly be put to better use!

Getting Rich on the Buyers' Ignorance

Few people know it, but American life insurance companies have amassed more money than any other financial institution except the banking industry. Approximately **$700 billion** are controlled by these giants. Each year, they collect over $50 billion in premium payments, and add about $60 billion in profits to their balance sheets. Not too shabby. For them, not us.

Two out of three Americans have life insurance. We work an average of one week each year just to pay for it. And what sort of returns do we get on our investment?

> **For every *dollar* that the nation's more than 2000 life insurance companies receive as income from premium payments and investment earnings on individual policies, they pay out an average of just *14 cents* in death benefits! Another *27 cents* are paid out as investment returns and benefits. That leaves the policy holder with an average of just *41 cents* for every dollar the companies get from him. What a deal . . . for the company!**

Don't let these statistics sour you. *You're about to learn how to make the system work for you,* even if it isn't working for your brother-in-law (unless he's a life insurance salesman).

What Kind of Insurance?

Basically, there are only two types of life insurance—permanent insurance and term insurance. Permanent insurance is what the insurance industry wants to sell you. That's why they call it "permanent." It sounds so secure.

Look, if you pay the premiums on time, *all* life insurance is permanent. This includes whole life, modified whole life, universal life, variable universal life, etc., etc. This "permanent" business is a sales ploy. Be prepared.

Most "permanent" insurance policies require you to pay level premiums. In other words, the annual or monthly payments are the same throughout the life of the policy, or the life of you, whichever ends first.

"Let me understand this," you say to yourself. "I'm getting older. As I get older, the risk to the company of insuring me increases. Yet my annual premium is fixed. So the insurance industry is giving me *something for nothing* as I get older." Red alert, red alert!

What they never tell you is that *your actual insurance coverage keeps dropping.* Let me explain. A "whole-life" policy builds up "cash values." That means cash. You can borrow it. (Terrific: you can borrow your own money and pay them interest for the privilege.) If you die before you repay the loan, they pay your heirs the face value of the policy, *minus* the loan.

Something funny is going on here. Funny peculiar, not funny amusing.

Let's say that you purchase a life insurance policy with a face value of $100,000, and you pay your level annual permiums for twenty years. By that time, let's say the cash-value (cash fund) might have grown to $50,000. How do you get that money? Two ways—either you surrender the policy and lose your coverage, or you have to borrow it from the company, and pay interest on it.

Term Life Insurance

Term insurance is pure protection. Every dollar spent in the premium (less the initial policy issue fee) goes for the purchase of insurance. There are no forced savings funds or other expensive ex-

tras. You don't pay interest to borrow your own money, *because you kept your own money from the beginning.*

Term insurance renews annually, and the premiums increase each year as you grow older. More risk means more cost. Simple. Anyone can understand it. Which leads me to my next rule for buying life insurance:

If you don't understand the policy, don't buy it.

Just as with cash-value insurance, there are many different types of term life policies—annual renewable term, level term, decreasing term, etc., etc. Most of the large insurance companies offer term insurance, but only a small percentage of the insurance salesmen want to sell it. Because term insurance represents pure protection, with no expensive savings fund—*expensive to you,* not to the company—the cost to you is usually much lower than cash-value insurance. As a result, the salesman's commission is much lower also, as noted above.

In comparing term insurance to whole life or universal life insurance, it's important to recognize that while the cost of term insurance is much lower during your twenties, thirties, and forties, it will be much higher in later years when the mortality rate is much higher. But that's the reality of life expectancy. The difference is, **term insurance premiums tell you *honestly* how much *real* protection costs.** No hidden assumptions. No hidden returns to the company. **Reality intrudes.**

Your heirs *need* more coverage when you're young, before you've built up an estate. Term insurance should be considered as an estate-builder for your heirs; the larger your estate, the less they need (except to pay estate taxes). The older you get, (usually) the less you need.

Unfortunately, you probably have two or more cash-value policies in your safety deposit box. If your policies were purchased more than a couple of years ago, they probably don't provide nearly the amount of cash-value percentage return as we have shown above.

It's time to dust-off those old policies and have them evaluated. Chances are very good that it will pay you to convert to term insurance and start saving *your* money for *your* needs.

In other words, call **InsuranceQuote**, toll-free: **1-800-972-1104**; in Texas: 214-490-7720 (collect).

Conclusions

I realize that this chapter could cost an investor thousands of dollars in order to implement its recommendations. I realize that many of my readers just don't have this kind of money. Still, as I have said repeatedly, it is far better to start some kind of long-term capital preservation program than none. It is better to take a few of the proper steps than to stand pat with conventional investments and savings programs. You can do something about your future, even though you can't do everything. You should not be paralyzed into inaction just because you think you can't accomplish everything in this book. Unless I sell a lot of newsletter subscriptions, I can't afford to take all the steps myself. What I am trying to do is to take those steps that fit my circumstances best. I offer many avenues of investing and buying because I have to cover a lot of different circumstances that my readers may be in.

I want you to get out of most conventional investments (except that most conventional of investments, your home—if it is in a safe location). I want you to be able to look back at your decisions over the next few years and say to yourself, "It's a good thing I took that book's advice, or I would be in poor shape today." If you can do that, we will both be better off. The only ones who will be worse off are employees of the government and government dependents who believed political rhetoric. For them we need shed no tears. If it weren't for the present governmental policies of theft, forced redistribution, and the subsidizing of the indolent all over the world—necessary if a civil government is to replace the family and local voluntary agencies in the government's quest for total power—we would not have to take such drastic investment and survival measures.[4] Let us never forget that the Federal, state, and local governments got us into this mess. It is up to us, as individuals, to take action to get ourselves out of the government-created mess, and then put government on a crash diet. If we are going to build a better world after the coming collapse, we had better have some resources left in our possession. We will not be able to rebuild if we perish in the meantime. Start taking evasive action.

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4. See my book, *Successful Investing in an Age of Envy* (Fort Worth, Texas: Steadman Press, 1983): $19.95.

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LOOPHOLES IN THE CHAOS

Price controls work. Let no one tell you differently. They accomplish their statist goals, though not their stated goals.

Why do governments impose price controls? The main reason, of course, is to stay in power. That's why governments do everything they do. More specifically, legislators impose controls to satisfy the demands of the public to "do something" about rising prices. If legislators take what appears to be positive action, then any negative results can be blamed on those people in the community who are not law abiding.

The purpose of price controls, politically, is to provide *nongovernmental scapegoats* for the failure of government policy, and to provide *self-serving explanations* for any part of the program that the public favors. Every failure is explained in terms of the failure of private citizens to abide by the rules set forth by the government. Every success—meaning either undetected failure or aspects of the economy untouched by the controls—becomes a B.ownie point for the regulators and the statist philosophy of messianic salvation.

People inevitably fall into the intellectual trap which some economists have called "the fallacy of the thing unseen." The public looks at the "positive" government program. The program is launched in terms of universally agreed-upon general goals. The program is staffed by "experts." It is comprehensive. It offers the public hope. When it fails, the program cannot be scrapped. Too many special-interest groups have grown accustomed to the benefits of the program—benefits that come from the pockets of the majority. The potential opponents, meaning those who pay for the benefits of the minority, either do not recognize the nature of the wealth redistribution scheme, or else they find it too expensive to organize all the potential opponents of the program. The beneficiaries are a concentrated pressure group with a direct interest in the continuation of the

program. So the failure is blamed on someone else. The public sees the program, listens to the rhetoric, and hopes. The failures are blamed on others. The bureaucrats get lodged in their Civil Service-protected positions, and the program becomes permanent. The costs of the program cannot be estimated easily, and the government and its beneficiaries have no incentive to get those costs estimated. They advertise the benefits and suppress knowledge of all costs. The *things unseen*—all those projects that might have been begun had men been allowed freedom—go unseen for generations. They are forgotten. The government advertises the successes, suppresses the failures, blames others for whatever failures become apparent, and the public pays the freight.

Don't people learn from history? How many times have I heard that phrase? The phrase is ridiculous. The next time you start to use it, bite your tongue. The very fact that critics of contemporary insanity, which is in fact the ancient insanity of messianic statism, keep repeating the phrase, indicates that the critics don't learn from history. *What history teaches clearly is that people don't learn from history.*

History teaches nothing to those who hold a philosophy contrary to the truth. All historical facts are reinterpreted by the statists to conform to their philosophy of statism. Does Galbraith learn from history? Did Hubert Humphrey? History is not some systematic collection of indisputable facts; it is an exercise in faith. It is factual, but different men interpret the facts differently. You have to start with first principles of interpretation to learn anything from history, and history does not advertise these first principles, or at least not loudly enough to catch the attention of the utopians.

Price controls lead to shortages, production bottlenecks, crises, family disruptions, and a long list of demonstrable disasters. But the demonstration can be made successfully only by someone who believes and understands economics, as well as the proper use of historical documents, and the demonstration can be convincing only to someone who has some grasp of economic theory, or at least the principles of liberty. There are very few teachers today, and the listeners who can make use of what the teachers have to say are also few in number.

The *results* of price controls are abhorrent to most people who are the victims. But the victims almost never understand that the results are actually the product of the price control system. Herein lies the

awful truth. *Price controls produce bad economic results, but the public universally misunderstands cause and effect in economics.* They call for even greater enforcement of the controls in order to alleviate the results which are perceived to be burdensome. They do not learn from history because they do not understand the blessings of liberty or the logic of economics.

The Chaos of Regulations

How, then, can we escape the seemingly inevitable drift into price controls? For the individual, there are ways to mitigate the effects of controls, temporarily, in some cases, for some families, so long as the controls don't last too long and are not rigorously enforced everywhere.

What we need to survive are loopholes. Fortunately, every system of government legislation ever devised has loopholes, and every enforcement mechanism provides even more ways to escape. The mills of justice grind slowly, but they grind exceedingly lumpy.

First, and foremost, the regulators want to achieve *contradictory goals,* and they have *competing programs* to achieve them. The bureaucrats are not able to devise a truly comprehensive and complete system of controls. (In fact, we are told by mathematician-philosopher Kurt Gödel that the human mind is theoretically incapable of devising any system that is both comprehensive and complete, meaning completely in agreement with original premises.) So there will be loopholes in the original legislation. The idea is to slide through the contradictory and incomplete regulations for as long as possible. There are holes in the government's many dikes. Never forget, the government doesn't know what it wants to accomplish, other than tenure.

Edward Knight, an economist in the industrial organization section of the Library of Congress, has produced several studies of price controls in recent U.S. history. His study of Nixon's early controls, "The New Economic Policy," was published by the Library of Congress' Congressional Research Service on August 30, 1971 (71-202E). His comment on the 1942 price freeze is revealing:

> However, from the very outset it was realized that the administration and the enforcement of the regulation would be complicated by a number of unresolved issues—namely: What products and producers, if any, should be exempted from price control? What standards should govern

exemption? What factors were to determine the setting of maximum prices? Where should ceilings be set to be generally fair and equitable to both consumers and producers? If profits are a measure of fairness to producers, how were they to be measured? Should profitability be applied to each of an industry's products or to all of its operations? Should profits be computed as a return on investment or as a return on sales? Should a single ceiling be established for all sellers in a trade or should different maxima be established for different classes or sellers or for individual firms? What allowances should be made for decreases in costs and increases in profits? Should maximum prices be established through base-date freezes, through formulas, or set forth in dollars and cents? (pp. 6-7).

This is one of the finest statements of the problems that I have ever seen. Back in 1920, Ludwig von Mises gave us the answer: *the government cannot possibly find the answers.* There is no other answer. Without a free market, it is not possible for the government to assess true costs. Only acting participants can make such estimations, and the continually shifting results of their continual evaluations and re-evaluations are prices. Yet it is the price system which all socialist governments are trying to abolish or at least control. Thus, the bureaucrats cannot answer even one of Knight's questions, let alone all of them, and not by any stretch of the imagination (or computer print-out) could they answer all of them so as to produce an integrated, effective, cost-efficient economic plan.

Does this impress the controllers? Not a bit. Did they find answers to these problems? Not a one. They didn't have to find answers. This is the very heart of the price control system. *The government does not have to find answers because the goal of the control system is to create a scapegoat mechanism which is a political substitute for answers.* That's it. If you try to seek out the inner truth of controls, you will search in vain. The truth of price controls is best seen in a cartoon of a ring of men, each pointing to the person on his left. Better yet, a massive crowd of bureaucrats pointing to another crowd of productive citizens who are trying their best to satisfy consumer demand with a diminishing quantity of resources.

The second fact of price controls is that *there are not enough regulators to enforce the controls.* There is too much paperwork. too much confusion. They can harass an individual proprietor, whether or not he has done something wrong, but they cannot enforce their regulations

on more than a handful. The whole system rests on voluntary compliance, and the more people comply with irrational pricing directives, the more crises hit the economy. This eventually leads men to try to evade the regulations that they say they believe in. What producers want is simple: "Let the government enforce controls on my suppliers; let me alone to sell at a free market price (unless the state grants me a monopoly and the right to charge a monopoly price)." They will not achieve this goal.

There are not enough resources available to controllers to enable them to confiscate all resources. They will try, of course, but they cannot succeed. Their success creates built-in resistance. The public starts to hide resources. Men cheat. They evade. Only a few can be caught. They vote for the controls, but they do not act as though they believe in them. They are schizophrenic, and their confusion allows clear-thinking men to survive.

Fast Action

The secret of profit is knowledge. Your competitors are ignorant. They are also inveterate optimists. When Nixon imposed price controls on August 15, 1971, he promised: "Our best days lie ahead." In the midst of a massive, thoughtless destruction of American liberties, Nixon announced to the American electorate:

> As we move into a generation of peace, as we blaze the trail toward the new prosperity, I say to every American: Let us raise our spirits. Let all of us contribute all we can to this great and good country that has contributed so much to the progress of mankind.
>
> Let us invest in our Nation's future; and let us revitalize that faith in ourselves that built a great nation in the past and that will shape the world of the future.
>
> Thank you, and good evening.

About all that you can say about that speech is (1) he obviously wrote it himself, and (2) it is covered by President Ford's pardon.

But Americans cheered. The polls showed that over 75% of the voters favored the move, and the majority of businessmen did, too. *He offered them hope—hope in the results of government coercion.* That hope dominates our age.

While there is hope, there is time to act. While the lemmings who believe in the theology of statism glow in the sunlight of the latest cure-all out of Washington, the intelligent strategist can act. *The*

Wall Street Journal for August 26, 1971, reported: "Progress Report: After 10 Days, Firms Say Equipment Orders Aren't Pouring in Yet." There was no rush to buy capital goods.

That meant that rational executives had at least ten days to begin to prepare for the shortages that the 90-day price freeze guaranteed. It also meant that there were few informed executives nationally. There will be more next time, but not many. *Optimism* and *ignorance* —a potent drug combination—work on the side of the man who takes fast action. Your competitors have *faith;* this gives you *time.*

Another fact: your actions will not be large enough for anyone to worry about. If you spread your purchases among several suppliers, you will leave no traces worth mentioning. People simply do not act in time. They seldom know what to do, and even when they do, they do not take those steps. *In the early stages of a price freeze, there will be time.*

Stages of Controls

First comes the freeze. This is what the public wants to hear. The government has at last taken action. It has answers. It has shown its mettle. People are reassured. There must be answers, and the government will provide them soon. The "cooling off period" will help give the economy a breather.

Nixon declared a universal freeze. Only raw agricultural products, interest rates, stocks and bonds, exports, and (for one week) school tuitions were left free. Oh, yes; taxes were also left free to rise. The consumer price index, which had been rising at about a 4% clip, then dropped to about 2%. But the 2% rise came in the middle of a universal price freeze. Conclusion: freezes are more like melts. Freedom dribbles back into the economy.

The pressures continue to build. A universal freeze is not politically possible. *The government has to backtrack.* The normal response is to freeze prices and wages of the largest, most visible, most central businesses, especially manufacturing. This has been true since the price control edict of the emperor Diocletian back in 301 A.D. About 800 different goods were covered. Violations were capital crimes. Thirteen years later, the system was scrapped. The empire was falling apart at the seams. This, of course, didn't prevent the pagan emperor Julian from trying the same thing 60 years later.

There is a kind of escalation of controls, with each series far easier to impose on the public. *First,* monetary inflation creates *price*

inflation. The statistics begin to worry the planners who are running the budget deficits that are being funded by the monetary inflation. So they call for restraint on the part of the public. This makes about as much sense as calling for restraint in the middle of an auction — an auction being innundated by new bidders holding fresh, crisp dollars, hot off the presses, so to speak. "Quit bidding so high," says the President. Meanwhile, the Treasury is borrowing a few billion from the Federal Reserve System, which in turn creates more money to fan the passions of the auction. And this auction can be paid for with credit, unlike conventional auctions. No wonder the bidders lose control of their emotions.

Second, when the bidders keep bidding up the price of the goods, the government imposes *guidelines.* These are usually voluntary at first. They may or may not have any effect. This was what happened during the first year of price guidelines of Roosevelt's war years, from February of 1941 until March of 1942. The guidelines had no teeth. Sooner or later, the Congress or the President will buy the bureaucrats a set of dentures.

Third comes the *freeze.* This is the freeze that doesn't. The best strategy is to begin to make purchases of long-term durable goods. Prices really are not frozen, especially prices of services. It is very interesting that after World War II ended, despite the frantic efforts of the price controllers to call a halt to rising prices, the price level skyrocketed. As Knight comments on the 1945-48 period (controls were lifted in October of 1946), "strong inflationary pressures were felt in virtually every sector of the economy. The only sector not so seriously affected was the service sector, and this was due mainly to the fact that the bulk of consumer demand was centered on durable and nondurable goods, whose supply had been either restricted or stopped during the war." More to the point, the price of services remained somewhat less active because services had been supplied at above-ceiling prices during the War. It is simply too hard to police the service sector of the economy. This is why it is far preferable to be a supplier of services than a supplier of manufactured products. They leave fewer records. They are easy to barter.

Fourth comes the *partial thaw.* The thaw is inevitable. The long list of unanswerable questions provided by Knight must be dealt with on an ad hoc basis by the price controllers. Some prices will be adjusted, new formulas will be devised, circumstances will be honored, and some degree of price flexibility will be restored. Not much

flexibility, you understand, but enough to give the planners something to do. If prices get out of hand—the bureaucratic visible hand—then another freeze may be imposed. But in any economy short of fascism, a degree of price flexibility will have to operate.

These four stages of controls provide the entrepreneur with opportunities for capital preservation. Minor upward adjustments are seldom recognized, and enforcers seldom discover them. When discovered, enforcers use a gentle touch, especially with first offenders. Small businessmen are left far more free than the regulations would indicate. Thus, the economy survives. If the controls were really enforced, the economy would be destroyed in the central population centers and seriously disrupted in the rural areas: feudalization.

The Age of the Caesars

Professor Hans Sennholz warns of a coming generation of fascism and controls, the Age of the Caesars. He is convinced that the ethics of envy will be put into force by fascist controllers. His Age of the Caesars is therefore the Age of the Seizers. The public will put up with the controls so long as they think that the rich and powerful are being put through the wringer of the control system. In such a period, the energetic, productive citizen is classified with the criminals. Nixon's August 15th speech is indicative of the mentality of the controllers: "In the past 7 years, there has been an average of one international monetary crisis every year. Now who gains from these crises? Not the working man; not the investor; not the real producers of wealth. The gainers are the international money speculators. Because they thrive on crises, they help create them." And what was the sin of these international money speculators? Why, to bet against the British pound, the Italian lira, the U.S. dollar. To ask for payment in gold, as guaranteed by the U.S. government. To hedge against inflation. To speculate against the International Monetary Fund, the intellectual creation of John Maynard Keynes. Worst of all, they had sought a profit through accurate forecasting, making the deliberate manipulations of the domestic monetary planners far more difficult, making the shearing of the average citizen more costly to the confiscators.

What was Nixon's response? He closed the gold window, thereby announcing to the world what the speculators had said for years: the U.S. dollar was an inflationary fiat currency. And what authority did he invoke to shut the gold window? None. That's right; he had

no statutory authority, he had no executive order up his sleeve, he had nothing. He simply told Treasury Secretary Connally to stop making payments in gold and to float the dollar in direct violation of IMF rules. There was not even the slightest pretence at creating a sense of legality.

The public cheered.

Caesar, you may recall, was a very popular fellow. He was also smart enough not to keep any tapes. Nixon wasn't so popular with those who wanted to destroy him, although Galbraith awarded his old subordinate in the Office of Price Administration an A – for his grade in economics ("Galbraith Gives Nixon an A-minus," *Business Week,* Oct. 16, 1971). Nixon did keep tapes. He is gone today, but the economics of Caesarism is with us still, for the ethics of Caesarism is almost universal.

Conclusion

There are ways to reduce the pain of controls. There are loopholes. Your job is to find them and squeeze through them. It can be done. It has always been done by a few in the past. Why not you?

The problem we all face is procrastination. Why not just "sit tight" and do nothing? we say to ourselves. Nothing to worry about. This too will pass. Yes, it will, and our capital may pass right along with it. *Procrastination and paralysis are the great enemies of profits.*

People in general will do nothing new. It is the procrastination and paralysis of the vast majority which opens the doors for the energetic few who will enter the markets and take a few risks. Let other people's procrastination work for you. Not everyone can squeeze through the loopholes. If everyone tries to get through "your" loophole, the government will try to close it. Your job is to act now, while it is still open.

CONCLUSION

Well, that's it. You now have more information on the strategy of economic survival under price controls than most people in the United States. At the very least, you have some idea of what to expect, and an idea of where to start. You have an edge on the competition—everybody in the Great American Auction—if you are willing to make use of it.

There are some very real profit opportunities ahead. I am not certain that anyone can really be better off under controls than he would have been without them. Price controls are really people controls. To lose your freedom and gain access to profits is probably not a good swap. But if the government imposes the controls, you have no choice. You either profit from the controls or lose by them. It is better to know in advance what kinds of economic and social disruptions are coming, and to hedge yourself against them while you can afford the price, than to go on ignorantly and be mugged by reality later.

I hope everyone who reads this book takes at least some of the steps outlined here. It will do you no good to have known what was coming if you never take any evasive action in advance. It does you no good to say, "I told you so," if you are talking to yourself.

The goal of profit should not be the mere amassing of goods. The whole idea of storing up wealth is to be productive with it when you need it later on. The wisdom of the Bible is applicable here: "Go to the ant, thou sluggard; consider her ways, and be wise: which having no guide, overseer, or ruler, provideth her meat in the summer, and gathereth her food in the harvest" (Proverbs 6:6-8). I hope that every reader who takes the proper steps to improve his chances of financial survival under controls will not forget the needs of others who have not had the opportunity to prepare. The division of labor is vital for the future of us all, and if some people need help to get

them though the crises, so that they can become productive again on the far side of price controls, then those of us who have planned wisely will be in a position to help others.

Another important consideration is this: *leadership requires leisure.* If good, productive people are to exercise leadership on the far side of disaster, then they will need assets to provide them with that leisure. What we aim at is financial survival, but survival is more than mere existing. It means being productive in many areas of life.

At this point, you may be saying to yourself, "This economic forecast sounds logical, but is it all true?" I can say with confidence that it is not all true. Exercises in economic forecasting are never all true. What you need to ask is, "Is a *lot* of this likely to take place?"

It all depends. Will the Federal Reserve System find some way to avoid recession (it didn't in 1969-70, 1974-76, and 1980-82) and also avoid price inflation (it didn't in 1965-70, 1971-75, and 1977-81)? Will some economist come up with an alternative to supply-side economics (abandoned by the tax hike of 1982), to Keynesianism (abandoned by younger economists, younger entrepreneurs, and a 70-year-old President), and to monetarism (not yet abandoned in late 1982 by the Federal Reserve System, but it is looking doubtful)? How can we increase government spending on national defense, continue to finance the mushrooming costs of welfare programs, lower tax rates, reduce price inflation to zero, get businessmen to invest, restore rapid economic growth, reduce unemployment, keep municipal and state budgets from going bankrupt, invest anywhere from $230 billion[1] to $700 billion[2] over the next decade in needed bridge and highway repairs, and balance the Federal budget? This is what we need to do, the politicians tell us. How will "we" do it?

We will not do it. The Social Security system alone will bring down the plans of the politicians. So what are they going to do in order to maintain the *illusion of Federal solvency* in the face of *national bankruptcy?* You and I have to guess. What seems to be the safest guess is that the politicians will return to the central bank (the Federal Reserve System), as politicians have done in Britain and France for 300 years, and demand that the bank finance an increasing

1. Federal Highway Administration estimate for the 1982-95 period: *Wall Street Journal* (June 22, 1982).

2. The estimate of Pat Choate and Susan Walter, *America In Ruins: Beyond Public Works Pork Barrell* (Washington, D.C.: Council for State Planning Agencies, 1981), p. 1.

portion of the Federal deficit—and everything else, if necessary. This means more monetary inflation. If we get more monetary inflation, we will get price inflation. And if we get a renewed burst of price inflation, the analysis I have offered in this book becomes far more relevant.

Maybe by the time you are reading this we will be under some sort of controls: credit controls, exchange (foreign currency) controls, "incomes policy" (wage controls), rent controls, or full-scale price and wage controls. If we are, then you may not care much about economic analysis. All you may be thinking about is how to implement a defensive strategy at the lowest possible cost.

Let me say it now: the lowest possible cost is *now.* (Actually, it was quite some time ago.) Yes, it will be more expensive today to achieve your goals than it would have been at the time I wrote these chapters (from 1975 onward). *But the past is gone forever.* You must not let your familiarity with past bargains that you missed paralyze you in a search for today's bargains. If you missed the best deals, forget about it. *Play with the cards you've been dealt.* The cards you held three hands ago don't count. Do the best you can with what you've got. You may not be the Sophia Loren of the investment world, but Zazu Pitts made a living, too. So can you.

What I have tried to do with this book is to outline a *general approach* to the controlled economy. I have offered some concrete suggestions. Few people will be able to afford to take all my suggestions anyway. What each person needs to do is look at his little niche in the economy and ask himself, "How can I best apply these principles of economic action to my particular situation?" No one can devise a strategy that will be absolutely what you need—not even you. We are all guessing. Price controls increase our uncertainty, since they hamper or destroy the *legal* free market, the greatest of all uncertainty-reducing human institutions.

You can read more. I think you should. You can then sit down and carefully catalogue every asset, every skill, every personal contact you have that could possibly make your life easier or your efforts more profitable. If controls are actually in place, you have little time to waste.

But what if controls are not in place yet? What if price inflation is still under 10%? Then we may have some breathing room. It may not look as though this Administration in Washington will put on controls. Of course, it did not look as though Nixon would in 1971.

And it did look as though Carter would during his Presidency. Looks can be deceiving. Act in terms of what you understand about economics and politicians, not in terms of today's temporary appearances.

What do you know about economics? Simple: *there are no free lunches*. What else do you know? *Supply and demand*. Take these two simple, fundamental, and inescapable principles and apply them, as best you can, to today's circumstances. Can the politicians achieve their stated goals, using your money, in a pain-free manner? If not, what are the most pain-free—politically pain-free for them—steps they can take that will cover their tails long enough to get re-elected? What will the bureaucrats do to preserve their protected positions at your expense? What will happen to your suppliers when the economy is wrapped in the straight-jacket? When you can begin to answer these questions, and apply the answers to your particular circumstances, then you are on the right path. You may yet beat the controls before they beat you.

"Junk Mail"

As I have mentioned previously, as inflation rises, it becomes more and more expensive to deliver information of new products and services to customers. People who are introducing new products, and especially new services, are forced to "target their audiences" and advertising dollars. *Once controls go on, it becomes difficult to sell certain kinds of information openly*. For instance, a display ad in a magazine advertising a book on how to beat the controls is almost assured of being rejected. Editors of conventional outlets for advertising are worried about becoming identified as unconventional, let alone illegal. What happens if newsprint is rationed, and the government starts putting pressure on them? Publishers start playing it safe.

This is why, under controls, one of the few ways to get news of a controls-beating program or approach to the public is to use direct-mail advertising. Even here, the risks are high. The government has introduced legislation that would enable the Post Office to confiscate "unconventional" mail-order books and materials, and force sellers to pay a fine of $10,000 per day if they continue to offer them for sale. Some variant of this legislation probably has been signed into law by the time you read this. Nevertheless, direct-mail advertising will be one of the best ways for advertisers to locate the more "in-

novative" and risk-oriented buyers of "unconventional" advice. I strongly recommend that you read very carefully all such solicitations. Sure, most of the offers will not be immediately useful to you. That is true of all advertising you are bombarded with. But direct-mail advertising is how the "little guy" in business can get access to a market for new, unconventional products. Don't toss out any offer until you have read it carefully. *The more direct-mail offers you receive, the more likely one of them will pay off for you.* It will take time to sort out the merits of each offer, but in a world of price inflation, government regulations, price controls, high taxes, and invasions of your privacy, you had better take some extra time, starting today.

I make this prediction: "junk mail" will eventually be one of the most important sources of relatively open, semi-public information on beating inflation and the controls that you will be able to discover inexpensively. The average American will never receive this sort of mail, because the average American doesn't know what is going on until it is way, way too late to do anything to defend himself. It will not pay advertisers to spend money trying to motivate the average American. In this sense, it isn't going to pay to be an average American. Today is your day to stop being average because you are thinking average. *You must start thinking unconventionally.*

Contact some or all of the companies listed in the appendix. Buy some of the books in the bibliography. (Some of them will be out of print already; don't assume books like these will always be easily available.) Start reading. If you won't read, you are asking for trouble. Information is never cheap; accurate information delivered on time (meaning well in advance of a crisis) is usually expensive, but it is always less expensive than what you will wind up paying if you don't get it in time. *The average person balks at paying for information. He expects it free of charge on the evening news.* The average American is going to pay through the nose for his "free" information over the next few years, just as he has paid through the nose since 1965. There are no free lunches or free investment information.

The Newsletter Industry

One of the most important sources of unconventional information today is the newsletter industry. There are several thousand independent newsletters on the market. What I have in mind, however, is the so-called hard-money newsletter industry. These newsletters are written by people who are convinced that the Federal government

cannot solve its problems, and will capitulate to short-run political measures tampering with the monetary system. Most of these authors think that mass inflation is coming, which will then be followed by deflation and depression. (I am in this camp.) A few others think that deflation is coming before mass inflation ever arrives (their numbers always decline during inflationary stages of the business cycle, e.g., 1971-74, 1977-80, and increase during the "disinflationary" stages, e.g., 1975, 1981).

There are many advantages of a hard-money newsletter. First, you gain access to "alternative information" sources. Second, you get summaries of conventional information that gets buried on page 24 of the *New York Times.* Third, you get a perspective; "facts" have to be selected and analyzed in terms of their importance. This means you need to pick and choose from millions of facts in terms of criteria of relevance. Pay someone you trust to pick and choose for you.

Newspapers and magazines are necessary in order to keep up with the overall picture. But the "overall picture" presented by conventional news sources is a *painted* picture. Sometimes the painters are blind to important details because of their ignorance of economics, or their outright hostility to economics. (Try to find favorable stories on barter or hoarding during a period of price controls. See if *Newsweek* and *Time* identify ways for you to participate successfully in the various "alternative markets.") Did they tell you to buy gold in 1971?

There is something else most readers never think about: conventional news sources make their money from *advertisers,* not readers. Readers are only the means to the end. The end is advertising revenue. Take a look at the advertisers who return again and again to the *Wall Street Journal* and other financial news magazines. If the editors depart too far from what big business regards as "true wisdom," the newspaper will encounter pressures. These pressures involve huge sums of advertising money. This is why you need information from a few other sources that come to you because you and other subscribers pay for it. The newsletter industry makes most of its money from subscribers; some letters make all of their money from subscription fees. In short, *newsletter editors must meet the needs of their subscribers*. The real money comes from *renewals*, not the initial subscription (which costs a lot to generate). If subscribers fail to renew, profits sag. Newsletters must satisfy subscribers, and *only* subscribers; advertisers have no clout with editors of independent newsletters.

Naturally, *readers have to pay the freight to get truly independent news*. A major newspaper may cost only a few cents per day. The cost per page is very inexpensive. Of course it's inexpensive; there are advertisements on every page. So when you "hire" an independent publisher, meaning his staff, his research ability, his perspective, and his ability to dig into topics that aren't "respectable," you have to pay for it. I know of one newsletter that costs $15,000 a year. Only big businesses buy it. I know of others selling for $45 a year. It depends on what you want.

When you subscribe to a newsletter, most of your money isn't going for paper and ink to print the newsletter. It's going for research time, experience, and the advertising cost to the publisher of delivering the news about the opportunity of subscribing to his newsletter to potential subscribers. *Problem: the average investor thinks in terms of price per page, not his financial return on his newsletter subscription.* This is why average investors make only average returns on their money: they treat information as an almost free good. After all, they think, "we can get news for free in the CBS Evening News." Sure they can! And it's worth twice what they're paying for it: nothing.

Let me offer an example. I offer financial counselling to subscribers to my newsletter, *Remnant Review.* Today, I charge $200 per hour. Back before inflation got so bad, I charged $100 per hour. I once received a friendly letter from a subscriber who asked why I charged so much. He was a professional (radiation scientist, as I remember), and he wasn't paid $100 per hour, he said. Correct; but I am not guaranteed a salary. I am not guaranteed eight hours a day at $200 an hour. But that isn't the real issue. The question is: If I can make you or save you $1,000 or $10,000, are you willing to pay me $200 per hour, until I start running out of ideas that can help you?

This man saw no reason to pay me the money because he was not an entrepreneur, and he probably believed that he had no opportunities to make or save more money than my time was going to cost him. *He thought my advice was too expensive because he had no confidence in his own investment opportunities.* He did not think my advice could increase his net worth as a salaried man. He was probably correct; as long as he relied on a salary for his financial future, as long as he was unwilling to break out of his shell and start taking some risks to make some money, as long as he was content to be a "cared for" citizen rather than a man who could make his own way even if he lost his

job, there was not much I could tell him that would have been worth the consulting fee. And most people are a lot less innovative than he was; after all, he was a *Remnant Review* subscriber.

I once sat down with a young man who was a very successful speculator. He made $300,000 a year, he said, speculating in commodities. Maybe he did. I gave him one tip that would have saved him at least $15,000 a year, after taxes, for every year that he made $300,000. It was a very simple piece of advice. He should have thought of it, but he hadn't. I had. Let me assure you, he was happy to write me his fully tax-deductible check (since he was an investor who was buying investment advice) for $100.

The average man thinks the way the first man thought. The second man, who was much younger and far wealthier, understood just how valuable accurate information is. *The greater your vision, the more you are willing to pay for accurate information.* The newsletter industry is aimed at people who have this sort of vision. It is aimed at people who are willing to pay $100 a year to receive information that they value more than $100. They know that this world is not going to give them something for nothing. They are unlikely to make $1,000, or even $100, from news that they get from the CBS Evening News or *Newsweek.* But those who think they are never, ever going to make $100 or $1,000 from something they read about are unlikely to pay $100, tax-deductible, for a newsletter subscription. They are also not going to take any of the steps I have described in this book.

If someone came to you and told you that he had developed a formula for pumping oil out of abandoned wells at a cost of $5 a barrel, would you be willing to consider buying that formula? Assume that you have reason to believe he is honest. He doesn't have the money to develop the equipment needed to pump the wells, but he does have the formula. Would you ask him the following questions? "What kind of paper is the formula written on?" "Is the formula printed with a four-color process?" "What did it cost you to print it up?" "Will I get 200 pages of additional material, including 100 pages of advertisements, along with the formula?" Nutty questions, right? Yet these are the kinds of questions that people ask themselves when they first hear about newsletters. They paralyze themselves with stupid questions. These people would demand a four-color travel brochure and a discount coupon for a local Holiday Inn from

someone who wanted to sell them a map to Captain Kidd's treasure. They never ask themselves the obvious question: "Will I get a greater return from the investment information than it costs me to buy and act upon the information?"

The typical investor never asks himself this question. He worries about irrelevant issues. He worries about packaging. If his information sources are not conventional looking, and are not priced to sell on a local newsstand, he just isn't interested. If his next-door neighbor isn't reading it, then he is too scared to take the first step. That's why *you* can beat the controls. The average guy—meaning your competition—is not going to act. He is not going to see this book. He is not going to buy it if he stumbles across it somewhere, or sees an ad for it. He is not going to do anything innovative or risk-oriented. He is going to go to work, earn his minimal salary, and hope that his employer knows how to make enough money to keep him on the payroll. The average guy is going to remain at the mercy of his employer and at the mercy of the government-regulated economy.

Don't be an average guy.

What newsletters do you need? First, you need letters that are aimed at your specific occupation. You should be upgrading your skills and information all the time. Second, you may need a letter that deals with a particular segment of the market in which you want to become a specialist. Maybe you want to invest in the stock market. Maybe you think it is time to start a small business. Find out what letters are available in each field. One way to do this is through the services of the Select Information Exchange, 2095 Broadway, New York City, NY 10023. For a few dollars, you can sign up to receive samples and brief subscriptions to dozens of newsletters per field, and there are several fields to choose from. Write for a free catalogue which gives you more details about which newsletter categories are available and which newsletters participate in the program.

Bank newsletters can sometimes be useful, though don't expect to get forthright reports on the looming banking crisis. Morgan Guaranty Trust and Citibank in New York City publish free letters.

Morgan Guaranty Survey
23 Wall Street
New York, NY 10015

Monthly Economic Letter
399 Park Avenue
New York, NY 10022

All of the regional Federal Reserve Banks offer free newsletters.

You can get the addresses of the regional banks by writing to the Office of Public Affairs, Federal Reserve Bank, Washington, D.C. 20551. The best of the publications come from the Federal Reserve Bank of St. Louis: *U.S. Financial Data* (weekly), *National Economic Trends* (monthly), *Monetary Trends* (monthly), *International Economic Trends* (quarterly), and the *Review* (monthly). Write:

Federal Reserve Bank of St. Louis
P. O. Box 442
St. Louis, MO 63116

A very good source of overall news is the *Daily News Digest,* a privately published weekly newsletter. It gives eight pages of information each week drawn from numerous sources. There is no better single source of "alternative" news reporting. Address: P. O. Box 39850, Phoenix, AZ 85069 ($147/52 issues). Other newsletters are listed in the appendix on Sources of Information.

Remnant Review

My own newsletter, *Remnant Review,* is different from most other letters. It usually covers one topic per issue. My philosophy of investing and action is that it is better to know why you are taking action; you should know the risks and benefits in advance. I am not in the "guru" business. I don't think you should spend your money just because some "trusted expert" says to do it. The "expert" needs to explain just exactly why you should do it.

Naturally, a newsletter can provide only an introductory survey to a topic. A good report should lead readers to further sources of information. Only a few readers still follow through on any given recommendation, but anyone who wants to pursue a topic should know where to go. I also think it is best to sell information and only information; thus, I accept no kick-backs or commissions from those companies that I recommend. I make my money on renewals, not kick-backs. I also try to negotiate *discounts on products* that will save subscribers the cost of their subscription—after-tax money.

I believe that a newsletter should not promise miracles. It should give the readers their money's worth, but not continuous miracles. "Miracle workers" in the newsletter field eventually become desperate people; each issue has to be "hot"; the readers get used to sensationalism. My attitude in subscribing to a magazine or news-

paper is this: if I get two or three good ideas per year, or two or three really good investment tips that are suitable for me, in my circumstances, then it has been worth the subscription fee. People who expect a bi-weekly miracle for $95 a year are going to be disappointed —and possibly bankrupted. Sadly, there are a lot of "miracle-buyers" shopping around for a financial guru. They want miracles; they buy tragedies.

You have already seen what *Remnant Review* is all about. Several of the chapters in this book were first published as shorter, preliminary reports in the newsletter back in the mid-1970s. You have already read "sample copies" of *Remnant Review.*

If you had taken the advice in this book when it was first published in *Remnant Review,* you would have bought gold for under $200 per ounce, silver for under $5 per ounce, and single-family homes for under $50,000, even in Southern California. Now you will have to pay more. On the other hand, if my strategy is correct, you will be able to sell these items to late-comers for a lot more dollars than you will have to shell out today. Perhaps most important of all, if you do what this book suggests, and what I will write about in *Remnant Review* over the next two or three years, you may be able to "lock in" your position at prices you can afford now, but will not be able to afford if you wait.

Write:

Remnant Review
P. O. Box 8204
Ft. Worth, TX 76124

You still may be saying to yourself, "But I just can't afford $95." All right, do this much for yourself. Take a look at your life insurance coverage. Then contact Gary Halbert (for his address just keep reading). See if this insurance firm can sell you more life insurance coverage for less money than you are paving today. Just send him the following information on a sheet of paper or on a postcard:

Your date of birth
The name of your present insurance company
Your present coverage (dollar amount)
Your premium fee per year
The cash value, if any, in the policy
The interest rate at which you can borrow from it

You may not want to go to all the trouble of looking up this information. (If you don't know it off the top of your head, then you are almost certainly paying hundreds of dollars too much every year for your life insurance, since available rates have dropped sharply since 1981.) If you don't want to look it up, just send him: (1) your date of birth, (2) your present premium fee per year, and (3) the total amount of your coverage. He will send you back some low-cost alternatives. You will be amazed at the results. I predict that you will be able to buy the same amount of life insurance coverage for less money, and save enough to subscribe to *Remnant Review* for a year (tax deductible, if you are an investor), and still put after-tax money in your pocket. In fact, I think you will be able to double your life insurance coverage and still pay for a year of *Remnant Review*. Your heirs need a minimum of $100,000.

If I am correct, are you willing to subscribe for a year? After all, if this single tip saves you enough money to buy a year of *Remnant Review*, plus receive my additional investment book, and still puts money in your pocket, then you can't legitimately use the argument that you "just can't afford to get into the big investment league and subscribe to an expensive newsletter." Remember: *Remnant Review* isn't expensive, if you can save or make more than the subscription fee. I think you can.

In a sense, this insurance deal is a two-way test. First, *you can test me*. Is my advice valid? Can it save you money? If it does, you will get an idea of how I can help you. If it doesn't, then you can take my advice with a grain of salt—or maybe a whole salt shaker full. Second, *you can test yourself*. Are you really trying to find ways to improve your financial position? Are you really ready to explore new ways of doing things? Are you willing to invest a stamp, an envelope, and five minutes of your time in filling out a card or piece of paper (not even typed) to save yourself up to several thousand dollars over the next few years in insurance premiums. (That's right: up to several thousand dollars, depending on your present coverage and type of policy.) This is such a sure thing—a "slam dunk" strategy, to use basketball terminology—that if you are unwilling to do this, then you have to ask yourself this question: What am I really trying to accomplish with my money?

Let me give you a specific case. I have to carry a lot of life insurance, to cover tax liabilities, estate taxes, and an estate for my family. (Every family with a husband under age 50 probably needs a

minimum of $100,000, since few families in suburbia can be comfortable today on less than $18,000 a year, and inflation keeps rising.) The corporation which publishes *Remnant Review* also has to carry a lot of life insurance on my life to cover taxes and to insure that subscribers get their money back, or access to a substitute newsletter if I die. There is over a million dollars of life insurance coverage on my life. I previously dealt with a company which offered a highly competitive policy in 1980. One of the policies discovered in 1982 saves me and the corporation about $9,000 in premiums over the next decade. Do you think that was worth a letter and a 20 cent stamp? I thought it was. Write:

Gary Halbert
InsuranceQuote
P. O. Box 790127
Dallas, TX 75379

Conclusion

You know it as well as I do: there are no free lunches. There are hidden costs of so-called free lunches.[3] You had better understand that a government which promises free lunches to one group of voters will get the money to pay for these lunches from somewhere. Usually, the people who pay are the very same people who think they are getting free lunches. My favorite example is the person who thinks he is getting a "free" education for his children, and who is being ruined by property taxes that finance "free" schools. Another example is Social Security. Inflation is yet another example.

When the government promises you below-market prices for what you want to buy, get ready: you are about to get sheared. If you refuse to get ready, you *will* be sheared. If you start taking some of the steps I have outlined in this book, you may avoid the shearing.

Therefore, you must act. You must also read more. Then you must act again. You must get your own system of "positive feedback" going: read, act, learn from your mistakes; read, act, learn from your mistakes. . . . You have to get moving. If you stand still, you will be a very easy target. If you do nothing, you will almost certainly become a loser. The illusion of Federal solvency will

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3. Gary North, "The Hidden Costs of Free Lunches," *The Freeman* (April, 1978).

lead you into the same ditch that most voters are already headed for. It will take time and effort, and some capital, for you to get off the highway for economic lemmings which leads into the ditch.

This is a long-term program. I am not selling snake oil. There are no free lunches. What I have described may not be easy, but neither is surviving in an age of envy. If you close your eyes and ears, if you forget what you have now learned, if you walk away thinking, "Very interesting," and then do nothing about it, you will have no one to blame but yourself. Warning: you may turn out to be a very nasty self-critic when things go the way I have predicted, and you haven't followed any of my advice.

And when you begin your controls-beating program, don't forget my motto: "It is better to be rich and healthy than it is to be poor and sick."

BIBLIOGRAPHY

Let's state the obvious. We can't read everything. Furthermore, no one book will cover everything we need to know, even in a narrow, specialized field. Therefore, we have a responsibility to keep reading. We have to keep thinking and rethinking. There is no way that any "how to make a lot of money" book can show you how to do everything. I hope that my book has introduced you to a number of new ideas, and that these ideas will lead you to a series of personal investment strategies that will prove beneficial in retrospect. It is my hope that every reader will take on one area of specialization and make it his own personal "profit avenue." I am providing a minimal list of books that will help you to make concrete decisions about your personal investment future. This list is in no way complete. It is simply an introduction.

If you are content to have read my book, and my book alone, then you have not really understood the message of my book. If you sit on your hands now, you have made the very mistake my book was designed to warn against. Keep on pursuing knowledge. Spend some time and money to prepare yourself. Think about the various scenarios for the future, and start planning for them. The day you stop reading is the day your investment portfolio, whatever it is and however large or small it may be, is in danger. You cannot afford to park your brains. *Take time to read.* Forget about the $5 or $10 a book costs. That's peanuts. The real cost is the very valuable *time* you take to read and understand a book, not the purchase price. I have tried to find the best books in the various fields, so that you can save time searching out the ones that you need. Now you have a responsibility to buy and read the ones that you think will help you. You now have knowledge, since you have finished my book. With knowledge comes personal responsibility. However, with knowledge also comes power. Use your power profitably and responsibly.

I have given addresses and 1982 prices in cases where the books are self-published or difficult to locate. For all others, consult *Books in Print* at your local bookstore. Some may be out of print.

Price Controls

Mark Skousen, *Playing the Price Controls Game* (Arlington House)

The Illusion of Wage and Price Control (Fraser Institute, Vancouver, B.C.; $6)

Rent Control: A Popular Paradox (Fraser Institute, Vancouver, B.C.; $3) (The Fraser Institute's address is 626 Bute St., Vancouver, B.C., Canada V6E 3M1.)

Marshall Clinard, *The Black Market* (Patterson Smith)

Crawford Goodwin (ed.), *Exhortation and Controls* (Brookings Institution)

Nicholas Balabkins, *Germany Under Direct Controls* (Rutgers University Press)

Council on Wage & Price Stability, *Historical Working Papers on the Economic Stabilization Program, August 15, 1971 to April 30, 1974*

Investing

David Smyth, *You Can Survive Any Financial Disaster* (Regnery)

Douglas Casey, *Strategic Investing* (Simon & Schuster, $15.95)

Klein & Wolman, *The Beat Inflation Strategy* (Simon & Schuster)

John Pugsley, *Common Sense Economics* (Common Sense Press, 711 W. 17th St., Suite G-6, Costa Mesa, CA 92627; $13.25)

The Alpha Strategy ($14.95)

The Manual of Inflation Hedges (Kephart Communications, 1300 N. 17th St., Arlington, VA 22209; $10)

A Quick Course in Hard Money Investments (Kephart Communications; $10)

Norman Lamb, *Small Fortunes in Penny Gold Stocks* (Penny Mining Prospector, 11141 Georgia Ave., Silver Spring, MD 20902; $15.95)

Jerome F. Smith, *Silver Profits in the 80's* (Books in Focus, 1982; $16.95)

Howard J. Ruff, *How to Prosper During the Coming Bad Years* (Times Books, $8.95)

Survive & Win in the Inflationary Eighties (Warner Books; $3.95)

Collectors Markets

Donald J. Hoppe, *How to Invest in Gold Coins* (Arco).

Q. David Bowers, *High Profits in Rare Coin Investments* (Bowers & Ruddy Galleries, 6922 Hollywood Blvd., Los Angeles, CA 90028; $7)

Money and Banking

Murray Rothbard, *What Has Government Done to Our Money?* (Pine Tree Press; $1.50) Order from Foundation for Economic Education

Andrew Dickson White, *Fiat Money Inflation in France* (Caxton)

William Rees-Mogg, *The Crisis of World Inflation* (London: Hamish Hamilton; distributed by Blackwell's, Broad Street, Oxford, England; $2.50)

Antony C. Sutton, *The War on Gold* ('76 Press, P. O. Box 2686, Seal Beach, CA 90740; $10)

Mark Skousen, *The 1978 Insider's Banking & Credit Almanac* (Kephart Communications, 1300 N. 17th St., Arlington, VA 22209; $13)

Harry Browne, *Harry Browne's Complete Guide to Swiss Banks* (McGraw-Hill)

General Economics

Henry Hazlitt, *Economics in One Lesson* (McFadden)

Gary North, *An Introduction to Christian Economics* (Craig Press) First two sections

Murray Rothbard, *Man, Economy, and State* (New York University Press). Chapter 11, especially

Ludwig von Mises, *Human Action* (Regnery). Chapter 20 is crucial.

Ludwig von Mises, *The Theory of Money and Credit* (Foundation for Economic Education) The most important book of all, but academic and difficult.

All of these books in the general economics section are available from the Foundation for Economic Education, Irvington-on-Hudson, New York 10533. The Foundation offers a very fine free monthly magazine, *The Freeman.* You should subscribe to it. Also, they publish an important book list, Literature of Freedom, which is available on request. *Get on their mailing list!*

Real Estate

William Nickerson, *How I Turned $1,000 into Three Million in Real*

Estate—In My Spare Time (Simon & Schuster)

Al Lowry, *How You Can Become Financially Independent by Investing in Real Estate* (Simon & Schuster)

Daniel J. deBenedictis, *The Complete Real Estate Adviser* (Cornerstone)

A. D. Kessler, *A Fortune at Your Feet* (Simon & Schuster)

George Bockl, *How Real Estate Fortunes Are Made* (Prentice-Hall)

George Bockl, *How to Use Leverage to Make Money in Local Real Estate* (Prentice-Hall)

All of these books recommend using extensive debt to "pyramid" a real estate empire. This works all right in a pure, straight-line inflation. We may have recessions, price controls, and other disasters along the way. Therefore, these highly "leveraged" debt pyramids should be avoided in general, although limited debt can be used for short-term speculation (under six years). Try to keep your pyramid out of debt at least once every seven years for a full year. This keeps you from risking total collapse. The trick will be in knowing when to get off the debt pyramid. The books all show how to buy and sell, how to evaluate good buys, and how to trade properties to avoid paying capital gains taxes. But use the debt pyramid with caution. Remember, no debt pyramid expands forever. Debt is a tool for rapid accumulation of "hard goods," in this case income-producing real estate property, when debt-free investing would not be possible at all. You allow inflation to pay off your debt. But rent controls, rationing, and shortages threaten all investing, so plan to get off the debt pyramid at least by 1987.

Economic Newsletters

Not everyone would normally consider subscribing to an economic newsletter. They normally cost over $50 a year, they come out a couple times a month, or maybe only once a month, and they are small. The cost per page, compared to *Time* magazine, is astronomical. Why pay it? There are several reasons. For example:

1. You want innovative new investment ideas.
2. You want unconventional economic or political information.
3. You are short of time and want to "hire" someone else to do the massive amount of reading necessary to find the relevant bits of information.
4. You want someone with your basic perspective to summarize the news.

5. You want information from someone who isn't dependent upon advertising revenue.
6. You want to learn about new products and services from someone who isn't trying to earn a commission by selling something to you. ("Never ask a barber if you need a haircut.")

To buy these services, you have to pay more per word than you do with mass-circulation, advertising revenue-dependent, overly cautious newspapers and magazines. You have to pay unconventional subscription prices in order to buy unconventional information. If you are content to base your decisions on the mass media, as interpreted by the CBS Evening News, then you probably won't subscribe to a newsletter service.

The following newsletters constitute only a tiny fraction of those available. One organization that will send you dozens of sample copies of available newsletters for very little money is this one:

Select Information Exchange
2095 Broadway
New York, NY 10023

Drop SIE a card telling of your interest in finding out about their sample copy program.

Specific Recommendations

I'm in the newsletter business. It has been very good to me, so obviously I'm biased in favor of newsletters. But even if I weren't in the business, I'd subscribe to several of them. My time is way too valuable not to have a few full-time "information scroungers" working for me. *The more valuable your time is, the more you need succinct, well-researched newsletters.* A good rule to follow is never to become wholly dependent on a single newsletter's advice (yes, even my *Remnant Review).* Follow the old biblical proverb: "Where no counsel is, the people fall: but in the multitude of counsellors there is safety" (Proverbs 11:14). Most of these can be sampled by sending $3 for the latest issue. (In the case of *Remnant Review,* you already have about 20 samples, since each chapter of this book represents one issue of the newsletter.)

Remnant Review (P. O. Box 8204, Ft. Worth, TX 76124; $95/22 issues). Almost everything is covered from time to time; shortages, controls, real estate, precious metals, alternative currencies, unconventional inflation hedges, rationing, etc. It does not cover the

stock market, however.

Gary North's *Firestorm Chats* (P. O. Box 8204, Fort Worth, TX 76124; $120/24 tapes). "Hard-corps" 90-minute tapes on all aspects of world affairs, plus interviews with key personalities. No holds barred.

Howard Ruff's *Financial Survival Report* (P. O. Box 2000, San Ramon, CA 94583; $145/24 issues). This 8-page newsletter covers several topics each issue. It is a good one for newcomers to the "hard money" field. The toll-free hot-line is a bargain. Subscribers can call in any time for investment advice (except stock market and bond market advice).

Daily News Digest (P. O. Box 39027, Phoenix, AZ 85061; $147/52 issues). For the busy professional, this letter is indispensable. The editor culls from dozens of sources the latest news on gold, silver, energy, national defense, investment alternatives, Federal statistics, and other topics that catch the fancy of newsletter readers. You can skim this and get the highlights of the U.S. financial press. Weekly.

Personal Finance (P. O. Box 9665, Arlington, VA 22209; $94/24 issues). A very good introductory letter to alternative investments in general. Less expensive than most. An all-purpose investment letter. Highly recommended.

Common Sense Viewpoint (711 W. 17th, Suite G-6, Costa Mesa, CA 92627; $75/12 issues). A mini-book each month. Very libertarian editorial policy. It covers stocks, commodities, and interest rates each issue, plus a main investment editorial of several pages. Edited by John Pugsley.

World Money Analyst (10076 Boca Entrada Blvd., Boca Raton, FL 33433; $135/12 issues). This letter is jam-packed with analysis, plus a monthly interview in depth with an important "hard money" expert. Regular columnists cover commodities, metals, inflation, and the world economy. Lots of information for the money. Very much an "Austrian School" (Prof. Mises) oriented letter.

World Market Perspective (WMP Publishing, P. O. Box 2289, Winter Park, FL 32790; $96/12 issues). This is another "Austrian School" perspective newsletter. It covers one topic in depth each month. Its specialty is the precious metals. Clients of the company receive it free. They sell leveraged silver accounts through Swiss banks.

McAlvany Intelligence Advisor (P. O. Box 39810, Phoenix, AZ 85069; $107/12 issues). Very good letter written by a gold coin specialist. Hard-hitting, readable analysis. Good on banking, too.

P S Letter (P. O. Box 598, Rogue River, OR 97537; $125/12 issues). For anyone who is seriously worried about economic breakdown, the *P S Letter* is indispensable. The editor, Mel Tappan, is a dedicated survivalist, and no newsletter has more accurate, more pertinent information on survival equipment and strategies. It's "far out" by today's standards; by the standards of 1986, I think it's better to aim in the same direction Tappan is shooting at.

Tax Angles (1300 N. 17th St., Arlington, VA 22209; $60/12 issues). A very useful newsletter for small businessmen. No other letter covers taxes and tax hedging better than this one.

Gary North's Investment Coin Review (P. O. Box 8204, Fort Worth, TX 76124; $67/12 issues). This is a good introduction to the whole field of rare coin investing. For the investor looking for a neglected "hard money" field rare coins is just about the best.

Dow Theory Letter (P. O. Box 1759, La Jolla, CA 92038; $185/26 issues). A good stock market letter from a master of the Dow Theory system. Technical analysis, with some fundamentals.

Don Bell Reports (P. O. Box 2223, Palm Beach, FL 33480; $40/26 issues). A good report on politics, economics, and bureaucratic intervention. Reasonably priced. Close watching of the Washington policy makers.

Audio Alert (108 Galewood Rd., Timonium, MD 21903; $140/12 tapes). This service provides a monthly series of interviews, 4 each tape. For busy businessmen who can use a car tape player to educate themselves while driving, this is a good service. It also includes a printed summary of the 4 interviews for handy reference.

Free Bank Newsletters

Monthly Economic Letter (Economics Dept., Citibank, 399 Park Ave., New York, NY 10022)

Morgan Guaranty Survey (23 Wall St., New York, NY 10015)

World Report (First National Bank of Chicago, Business and Economics Research Division, One First National Plaza, Chicago, IL 60670)

St. Louis Federal Reserve Bank

This organization publishes several sophisticated reports that are available free of charge. The research staff of this Federal Reserve Bank is more free market oriented than the others. For what it's

worth. (P. O. Box 442, St. Louis, MO 63166)

U.S. Financial Data (weekly)
Monetary Trends (monthly)
National Economic Trends (monthly)
International Economic Conditions (quarterly)
Monthly Report

Magazines

Mother Earth News (105 Stoney Mtn. Rd., Hendersonville, NC 28739; $12/6 issues)

Acres, USA (P. O. Box 9547, Raytown, MO 64113; $7/12 issues)

Organic Gardening & Farming (33 East Minor St., Emmaus, PA 18049; $7.85/12 issues)

Home Energy Digest (8009 34th Ave., So., Minneapolis, MN 55420; $7.95/4 issues)

Woodstove Directory (P. O. Box 4474, Manchester, NH 03108; $2.50/1 issue)

SUPPLIERS

You need to know which firms can help you in developing your own personal strategy for evading the economic effects of envy. There are a growing number of firms that are "hard money" oriented. I decided to list the firms I believe are reputable in an appendix to this book beginning with the 1977 edition. I encouraged Howard Ruff to do the same in his book, *How to Prosper During the Coming Bad Years.* (I did personal telephone consulting for the *Ruff Times* as an independent consultant from early 1977 until the fall of 1979.) Without at least a preliminary list to consult, the "newly initiated" reader may not know where to begin.

I am absolutely adamant about the importance of gold and silver coins. They must be in anyone's portfolio. Small investors have a problem, however: How to buy coins in small quantities? For individual coins, there are local coin stores and pawn shops, but these usually have high commissions (premiums) over bullion value. There is a firm that encourages the small investor, and beginners should consider using its services:

C. Rhyne & Associates
110 Cherry St., #202
Seattle, WA 98104
(800) 426-7835
(800) 542-0824 (Wash.)

Coins (bullion)

Burt Blumert
Camino Coin Co.
Burlingame, CA 94010
(415) 348-3000

Joel D. Coen
39 W. 55th St.
New York, NY 10019
(800) 223-0868

Deak & Co. (many cities)
1800 K St., N. W.
Washington, D. C. 20006
(800) 368-5683

Investment Rarities
1 Appletree Square
Bloomington, MN 54420
(800) 328-1860

Coins (rare)

See my newsletter *Gary North's Investment Coin Review* for a complete listing.

Food Storage

Simpler Life Foods
P. O. Box 2059
Hereford, TX 79045
(806) 364-0730

Martins Distributing Co.
P. O. Box 725
Carlsbad, CA 92008
(800) 824-7861

Survival Products

SI Outdoor Food
& Equipment
2322 Artesia Blvd.
Redondo Beach, CA 90278
(213) 324-8855

Survival Center
5555 Newton Falls Rd.
Ravenna, OH 44266
(800) 321-2900

"Penny" Mining Shares

Bob Chapman
Investors International Securities
32123 Lindero Canyon Rd.
Westlake Village, CA 91361
(818) 991-9240

Mutual Fund (energy & minerals)

Financial Industrial Income Fund
Financial Programs, Inc.
P. O. Box 2040
Denver, CO 80201
(800) 525-9831

Mutual Funds (gold mining)

Golconda Investors, Ltd.
11 Hanover Square
New York, NY 10005
(800) 431-6060

United Services Fund
11330 Interstate Highway,
10 West, Suite 5300
San Antonio, TX 78229
(800) 531-5777

Mutual Funds (telephone switch)

Dreyfus Third Century
(Dreyfus #9: growth fund)
600 Madison Ave.
New York, NY 10022
(800) 645-6561

Energy Fund; Guardian Mutual Fund (both at same address)
522 Madison Ave.
New York, NY 10073
(212) 790-9800

Dick Fabian
P. O. Box 2538
Huntington Beach, CA 92647
(714) 898-2588

Mutual Funds (no-load directories)

Directory of No-Load Mutual Funds
No-Load Mutual Fund Association
11 Penn Plaza, #2204
New York, NY 10001
(212) 563-4540
($2.00)

No-Load Mutual Funds Membership List
Investment Company Institute
1600 M St., N.W. 6th floor
Washington, D. C. 20036
(202) 293-7700
(free)

Mutual Funds (no-load growth funds)

Newberger Birman Management
342 Madison Ave.
New York, NY 10173
(800) 367-0770

Mutual Shares Corp.
1700 Broadway
New York, NY 10038
(212) 267-4200

Money-Market Funds

Capital Preservation Fund
(T-bills)
755 Page Mill Rd.
Palo Alto, CA 94304
(800) 227-8380
(800) 982-5873 (Calif.)

American Liquid Trust
Box 2121
Boston, MA 02106
(212) 267-4200

Life Insurance

InsuranceQuote
P. O. Box 790127
Dallas, TX 75379
1-800-972-1109

Lawyers (trusts, estates)

Michael Ushijima
Law Offices
6300 River Rd., Suite 100
Rosemont, IL 60018
(312) 696-3466

B. Ray Anderson
Newcastle Financial Group
1815 S. State Street, #450
Orem, UT 84058
(801) 224-9800

Leslie Powers
Powers & Therrien, P.S.
811 Summitview, Suite 4
Yakima, WA 98902
(509) 453-8907

William Reiser
1926 Tice Valley Blvd.
Walnut Creek, CA 94595
(415) 938-2500

Peter Lind
2122 - 112th Avenue, N.E., Suite B201
Bellevue, WA 98004
(206) 455-4240

INDEX

"Washington is deadlocked," says Dr. North. "The economy faces multiple crises. The Social Security system is going bankrupt. Taxes are high, and the politicians want to push them higher. Roads and bridges need at least half a trillion dollars worth of repairs, and the state treasuries are empty. If the deadlock continues, there will be only one politically acceptable solution: **emergency controls**."

What will controls mean for businessmen? Shortages and production bottlenecks. Rationing and red tape. Obedience to the whims of bureaucrats. Black markets, high prices, and pay-offs. "It will be like a wartime economy, without the patriotism," Dr. North warns.

What about consumers? Ration coupons, long lines, frustration, and unemployment. It will be a boom time for black markets and a sad day for pensioners.

What about investors? Economic stagnation, corporations hamstrung by regulations, and lower dividends. The bond market will collapse. A wave of paper money will hit the economy, but businesses will not be allowed to respond profitably. But there will be exceptions—pockets of profits in a sea of losses. "That's what ***Government by Emergency*** is all about," says the author.

"The average businessman in America isn't familiar with controls. In Europe, people know how to 'beat the system,' but not here. Either you devote a lot of time to studying economic history, as I did, or you buy a handbook, **in advance,** and start taking evasive action while it's still legal," says Dr. North. ***Government by Emergency*** is the handbook.

About the Author

Gary North is the author of numerous books, including *Marx's Religion of Revolution* (1968), *An Introduction to Christian Economics* (1973), and *The Dominion Covenant: Genesis* (1982). He has had essays and reviews published in dozens of magazines and periodicals, including the *Wall Street Journal, Commercial & Financial Chronicle, Numismatic News, Coin Mart, COINage, The Freeman, Modern Age, The Journal of Political Economy,* and *National Review.*

He served as a senior staff member of the Foundation for Economic Education in Irvington-on-Hudson, New York, and was research assistant for Congressman Ron Paul (R-Houston).

In 1974, Dr. North began publishing *Remnant Review,* one of the most popular of the "hard money" newsletters. He also worked for Howard Ruff's organization as a consultant in the late 1970's. He is a featured speaker at many investment seminars around the nation.

He lives in East Texas with his wife and four children, where he practices what he preaches: **low-profile living.** He drives a 1972 Toyota which needs a paint job but which is owned free and clear. His wife drives a Chevrolet station wagon. You will not find a photograph of him on this (or any) dust jacket. Ever. (When you have finished reading this book, you will understand why.)

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American Bureau of Economic Research
P.O. Box 8204
Ft. Worth, Texas 76112

The flood of inflation is rising. The little Dutch boy has his finger in the dike but he is about to be ordered to pull it out.

Your assets are your finger in the dike. You are about to be ordered to abandon your reserves against inflation.

The powers of the Federal bureaucracies are on the verge of being enormously expanded. Their jurisdiction will be extended overnight by already existing executive orders. Every area of your life will be affected; personal, family, and business.

You must protect yourself now before your legal and financial options are radically reduced. There are questions you must have answered if you want to protect everything you've ever worked for.

Why *Social Security obligations will be paid. . .and what they will be paid with? (see the chapter called: The World's Biggest Chain Letter)*

Why *you will never have to stand in line to get your money out of a bank. (p. 77)*

Why *emergency regulations are not on the visible, official books. . .yet they could be imposed at ANY TIME. (p. 115)*

Why *the basis of our economy is changing and how you can position yourself now to take advantage of tomorrow's few high paying occupations. (p. 173)*

Why *gold and silver are NOT crisis metals (p. 209) and what the best kind of capital really is. (p. 242)*

Why *there will always be loopholes in price controls (p. 303) and how you can avoid their squeeze. (chapter 14)*

This is a manual of self defense. You need to have YOUR line of defense up now, before any of the emergency controls are activated. This book tells you how. It tells you why. There is no other book like it. Government By Emergency belongs at the top of your list. It's that important.

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